RENEWED FINANCIAL SUPERVISION IN EUROPE – FINAL OR TRANSITORY?

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INTRODUCTION

In order to obtain financial sector stability, adequate financial regulation and supervision are paramount. Despite their crucial role, both failed to prevent or at least mitigate the financial crisis. While financial regulation strives to impose a set of rules that ensure a safe and resilient financial sector, it has proven to contain too many gaps and loopholes[1].

Financial supervision, for its part, mainly aims to monitor whether or not the financial sector abides by the relevant rules. When this is not the case, or when financial stability is at stake, supervisors should be able to bring about an appropriate response. Across the globe, financial supervisors failed in their duties. The financial crisis has shown that supervisors were not able to properly detect or give warning of emerging problems.

In the EU, the mismatch between the financial sector and its supervision further compounded the supervisory failings. The EU's supervisory structure proved unable to cope with the integration of the financial sector. Already by 2005, 23% of all banking activity in Europe was of a cross-border nature, largely exceeding the levels of integration seen in the American and Asian-Pacific financial sectors[2]. Despite this increased integration and inter-dependency, financial supervision in Europe had still remained almost exclusively a Member State affair. A certain asymmetry has, therefore, grown between the financial sector and its supervisors.

Such asymmetry between supervision and financial sector integration does not necessarily impede effective supervision, but it does require intense cooperation between the national supervisors. This was neither the case prior to or during the financial crisis. When crucial decisions needed to be made at the EU level, national responses, nonetheless, prevailed.

The supervisory failings led to calls for major reforms, which resulted in a set of reforms that were fully put into effect in January 2011. It was welcomed as an area of significant progress of the post-crisis reforms. This paper discusses the EU financial supervision system that came about in the wake of the post-crisis

1. For the failures of financial regulation, see for example: BRUNNERMEIER, M., CROCKETT, A. (e.a.), The Fundamental Principles of Financial Regulation, Centre for Economic Policy Research, 2009. For a discussion of the EU's regulatory response, see: VERHELST, S., Addressing the financial crisis: the EU's incomplete regulatory response, Egmont Paper, nr. 39, December 2010.
2. SCHOENMAKER, D., VAN LAECKE, C., Current State of Cross-Border Banking, LSE Financial Markets Group Paper Series, Special Paper 168, November 2006, p. 8.

reforms. By focusing on the powers and limits of the different supervisory levels, it aims to assess the system's chances of success.

In the initial chapter, the paper discusses the former supervisory system, as well as its shortcomings. Chapter 2 provides a general overview of the reformed supervisory system. Subsequently, EU level supervision is detailed, both in terms of its macro-prudential arm (chapter 3) and its micro-prudential arm (chapter 4). The other parts of European supervision, both national and cross-border supervision, are examined in chapter 5. The final chapter of this paper sheds light on the state of affairs regarding international supervision, before a conclusion draws together the relevant arguments and findings of this paper.

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3. The auteur is Research Fellow at Egmont – The Royal Institute for International Relations. The author would like to thank Professor Franklin Dehousse for his inspiring comments.

1. The Former EU Financial Supervisory System and its Shortcomings

The financial supervisory system that was in place on the eve of the financial crisis was the result of an evolution that stretched over several decades[4]. It had been influenced a great deal by the integration of the EU's financial services market. As often is the case, such integration has led to a harmonisation of the legal framework. Such a harmonisation equally required defining the responsible supervisor (see 1.1). This legal framework poses certain difficulties pertaining to the effectiveness of supervision and coordination between supervisors. Therefore, limited supervisory cooperation arrangements have been put in place (see 1.2). Despite these arrangements, financial supervision proved to be woefully inadequate, as was painfully demonstrated during the course of the financial crisis (1.3).

1.1. The Legal Framework

In discussing the legal framework governing the EU financial supervisory system, it is useful to separate the general legal framework applicable to the financial sector from the supervisory rules. The former is meant to result in a single EU market in financial services, while the latter serves to deal with the related consequences.

1.1.1. The basics of EU financial sector regulation

The EU legal framework governing the financial sector has been characterised by two interrelated principles: minimum harmonisation and mutual recognition. Both principles are well-established in EU law. Minimum harmonisation refers to the set of minimum requirements that apply to all financial institutions operating in the EU. For instance, these concern capital requirements and risk management[5]. Linked to minimum harmonisation is the principle of mutual recognition. This principle supports the free movement of goods and services in the EU. For the financial sector, it implies that a financial institution duly licensed

4. A first Directive aiming at harmonising the EU financial sector rules was already adopted in 1973, see: Directive 73/183/EEC, (OJ 1973 L 194/1-10). With regard to financial supervision, the Second Banking Directive is of importance, as it introduces home country supervision (cfr. infra), see: Directive 89/646/EEC, (OJ 1989 L386/1-13).

5. Most of the requirements are grouped in the Capital Requirements Directive, see: Directives 2006/48/EC (OJ 2006 L177/1-200) and 2006/49/EC (OJ 2006 L177/201-256).

in one Member State obtains a so-called passport, by which it can freely provide its services in the rest of the EU[6].

1.1.2. Supervisory responsibility

The EU rules have important consequence for supervisory responsibilities. Mutual recognition of financial institutions has resulted in home country supervisory control[7]. It implies that a financial institution is supervised by the Member State where it is licensed. This includes the supervision of cross-border operations, as well as the operations of branches in other Member States. For example, the French supervisor oversees a French bank's branch in Austria, as well as its cross-border operations in Belgium.

Home country control largely reduces the supervisory role of the host country. Supervision of the latter does not stretch much further than the supervision of a branch's liquidity provisions[8] and the collection of information for statistical purposes[9].

The situation is different however when a financial institution sets up a separate legal entity in another Member State, i.e. a subsidiary. As a subsidiary is conceived and licensed on its own, it is supervised by the country in which it was established. Nonetheless, the European harmonization process had facilitated the setting up of a subsidiary.

The supervisory arrangements have become increasingly challenged by the integration of the European financial sector. A sector that operates across borders requires an encompassing supervisory perspective. In an effort to adjust supervision to the increasing trans-national nature of financial supervision, the concept of consolidated supervision has been introduced. Such consolidated supervision designates a supervisor to oversee the financial situation of a banking group as a whole[10]. Supplementary supervision was put in place to allow supervisors to carry out cross-sectoral supervision, comprising for instance both banking and insurance firms[11]. These supervisory arrangements have in no way taken away the prime role of national supervision.

6. Article 16 of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, OJ L 177, 30.6.2006, pp. 201-255.
7. Article 40 of ibid.
8. Article 41 of ibid.
9. Article 29 of ibid.
10. Articles 125 and 126 of ibid.
11. Directive 2002/87/EC of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate [Recast], OJ L 35, 11.2.2003, pp. 1-27.

1.2. Limited Supervisory Cooperation

Despite the legal arrangements in place, it was difficult for national supervisors to have a complete image of the financial institutions under their supervision. Cooperation between supervisors proved indispensable. For this reason, supervisory cooperation arrangements had increasingly been put in place, both among individual supervisors and at the EU level.

1.2.1. Cross-border cooperation

EU rules stipulated that the home country supervisor should collaborate with the host state and provide it with the necessary information. While the rules required cooperation between national supervisors, they did not alter the home country supervisor's competences[12]. In case of disagreement, the home country had the final say.

In addition to EU legislation, supervisory collaboration and the common handling of crises had been outlined in several 'Memoranda of Understanding' between Member States. However, these Memoranda are by no means legally binding. This was particularly apparent during the financial crisis. Member States were inclined to circumvent the established channels of cooperation and opted rather for unilateral responses[13].

Other, more elaborate ways of cooperation were equally developed, notably colleges of supervisors (see 5.1).Despite their potential, only a handful had been created prior to the crisis. Those in place were still in their test phase when the financial crisis broke out and thus proved to be of little use[14].

1.2.2. EU level cooperation

The EU had already been attributed a role in financial supervision prior to the crisis. The Treaty on the Functioning of the European Union provides the European System of Central Banks (grouping the national central banks and the European Central Bank) with a role in supervision. It has been charged with "[*contributing*] *to the smooth conduct of policies pursued by the competent*

12. Article 42 of ibid.
13. CIHAK, M., DECRESSIN, J., The Case for a European Banking Charter, IMF Working Paper, July 2007, WP/07/173, pp. 6-7.
14. CEBS, Range of Practices on Supervisory Colleges and Home-Host Cooperation, December 2007, Retrievable on: http://www.eba.europa.eu/getdoc/2a41c4f5-f76c-4c53-a790-fcd8cd129bbb/CEBS-2007-75-(Range-of-practices)-final.aspx.

authorities relating to the prudential supervision of credit institutions and the stability of the financial system"[15]. This function was mainly exercised by the Member States' central banks.

Nevertheless, a number of EU bodies have been created to support national supervision. In the European Central Bank, the Banking Supervision Committee (BSC) had been established. It groups officials from the ECB, the national central banks and the banking supervisors[16]. As the Treaty stipulates, the BSC assists central banks in two fields: the supervision of credit institutions and financial system stability[17]. As the BSC was only to provide a supporting role, it did not have any legally binding means at its disposal. The BSC's role and competences have remained unaltered by the post-crisis reforms[18].

The 2001 Lamfalussy Report[19] had an important impact on EU involvement in financial supervision. The Report led to the creation of a four level structure to adopt and implement financial regulation. Of this structure, the third level plays a particularly pertinent role with regard to financial supervision. At this level, three sectoral committees were put in place, grouping respectively the national supervisors of the banking sector,[20] the securities sector[21] and the insurance and occupational pensions sectors[22]. The tasks of these Lamfalussy level 3 Committees expanded over the years. Eventually, the Committees' main tasks were (1) facilitating mediation between supervisors, (2) contributing to the consistent implementation of Union directives, (3) reviewing and converging supervisory practices and (4) enhancing information exchange and supervisory coordination[23]. The Lamfalussy level 3 Committees were to pursue these tasks using non-binding instruments[24]. Moreover, decisions by the Committees were to be made by unanimity. Only when a consensus was not feasible could decisions – by way of exception – be taken by a qualified majority.

15. Article 127(5) of Treaty on the Functioning of the European Union, OJ C 83, 30.3.2010, pp. 1-388.
16. The Committee was established in 1998 and succeeded the Banking Supervisory Sub-Committee, which had been created by the Committee of Governors in 1990.
17. SCHELLER, H., European Central Bank. History, Role and Functions, European Central Bank, 2006, pp. 111-113.
18. This is contrary to the de Larosière Group's recommendations, which proposed to replace the BSC by the new macro-prudential supervisory body (see 3).
19. Lamfalussy Committee of Wise Men, Final Report on the Regulation of European Securities Markets, 15 February 2001.
20. The Committee of European Banking Supervisors (CEBS), established by Commission Decision 2004/5/EC of 5 November 2003, OJ L 3, 7.1.2004, pp. 28-29.
21. The Committee of European Securities Regulators (CESR), established by Commission Decision 2001/527/EC of 6 June 2001, OJ L 191, 13.7.2001, pp. 43-44.
22. The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), established by Commission Decision 2004/6/EC of 5 November 2003, OJ L 3, 7.1.2004, pp. 30-31.
23. See Article 4 of Commission Decisions 2009/77/EC, 2009/78/EC and 2009/79/EC (OJ 2009 L 25/18-32).
24. See Article 3 of ibid.

These bodies were not without any value. However their reliance on non-binding, soft-law instruments did not enable them to gain enough influence on financial supervision in the EU, let alone steer it through times of trouble.

1.3. A Multitude of Supervisory Shortcomings

In retrospect, it becomes clear that the pre-crisis supervision arrangements in place had considerable shortcomings. Supervisors were unable to detect, signal or mitigate the financial crisis and thus failed to perform their core tasks. At the heart of this failure lies a multitude of mutually reinforcing problems. Some of these are of a more general nature and apply to financial supervisors across the globe. Other problems are more EU specific as they result from the EU's supervisory structure. The remainder of this chapter discusses these two prominent problems.

1.3.1. Worldwide supervisory shortcomings

The EU was by no means alone when it came to inadequate and ineffective supervisory regimes. In other regions and in international organisations, supervisory arrangements also failed. Supervisory work did not result in sufficient policy action. Each element of the supervisory process, from initial assessment to policy action, had distinct weaknesses.

a. A lack of attention given to emerging dangers

Supervisors focused too narrowly on verifying whether or not individual financial institutions applied the necessary rules. They did not sufficiently take into account the results of some general financial sector evolutions. Like regulators, the prevailing view among supervisors was that market discipline and self-regulation would be sufficient enough to ensure financial stability. Consequently, the importance of aggregate risks and overall stability were not attributed the attention they deserved.

Worth noting is the lack of attention given to the adverse effects of financial innovation. This is amply illustrated by the fact that financial institutions could transfer risks associated with inferior quality subprime loans to other financial institutions. By doing so, a financial institution – and the entire financial system as a consequence – had to hold fewer buffers. Yet, risk did not evaporate as it essentially remained in the financial system.

The focus on individual financial supervision proved erroneous. The financial crisis has shown that healthy individual institutions do not necessarily imply a healthy financial system. Before the crisis, this fundamental understanding was largely overlooked by supervisors[25].

b. *Incorrect assessment of emerging dangers by supervisors*

Even if there was in general a lack of attention for the luring dangers, this does not mean that such dangers were never given any thought. Several national[26] and international[27] bodies did evaluate overall financial stability and discuss evolutions in the financial sector. At the EU level, the ECB published bi-annual Financial Stability Reviews on the matter[28]. Nevertheless, when assessing issues such as macro-financial stability or financial innovation, supervisors often did not correctly assess the risks they entailed.

For instance, financial innovation was more often perceived as beneficial for financial stability and its associated dangers were largely downplayed[29]. When problems did arise, their potential impact was underestimated. The June 2007 ECB Financial Stability Review stated on the eve of the outbreak of the financial crisis:

> "*With the euro area financial system in a generally healthy condition and the economic outlook remaining favourable, the most likely prospect is that financial system stability will be maintained in the period ahead*[30]".

The fact that the underlying dangers were overlooked or underestimated by supervisors is not surprising. Supervisors face a difficult task. It is most challenging to detect adverse developments that can lead to financial instability. Supervision requires questioning conventional wisdoms, such as the advantage of spreading risks throughout the sector. Even if a danger is detected, it is often difficult to assess its potential scope. Moreover, as warning of a danger causes a market reaction, it can lead to a self-fulfilling prophecy. In such cases, it is

25. G-20 Working Group 1, Enhancing Sound Regulation and Strengthening Transparency – final report, March 2009, p. 2.
26. By way of example: the Belgian Central Bank published annual reports on financial stability, Retrievable on: http://www.nbb.be/pub/06_00_00_00_00/06_03_00_00_00/06_03_02_00_00.htm?l=en.
27. See notably the IMF Global Financial Stability Reports, Retrievable on: http://www.imf.org/external/pubs/ft/gfsr/index.htm.
28. For an overview of these reports, http://www.ecb.int/pub/fsr/html/index.en.html.
29. A 2007 IMF paper stated for instance that "*innovation has supported financial system soundness*". See: BHATIA, A., New Landscape, New Challenges: Structural Change and Regulation in the U.S. Financial Sector, IMF Working Paper, WP/07/195, August 2007.
30. ECB, Financial Stability Review, June 2007, p. 9.

tempting to fall back to what we know or believe, which might however lead to an incorrect assessment[31]. To make matters worse, supervisors often lacked staff and resources, making it all the more difficult to keep track with the fast-paced financial sector evolutions[32].

c. Warnings were insufficiently taken into account by policymakers

Although most supervisory reports failed to see the financial crisis coming, some of them actually did warn of the unsound financial sector developments that would eventually lead to the financial crisis[33]. Yet, policymakers either ignored or failed to grasp the seriousness of these warning. Indeed, such warnings were exceptions to generally positive analysis, but it would be short-sighted to see this as the only reason why they were left unheeded.

Policymakers dislike warnings by supervisors, as such warnings run against their short term interests. In many cases, such warnings concern core drivers of economic growth. The real estate and financial sector are clear examples. These drivers of economic growth rebuffed delocalisation and created well-paid employment. Acting upon reports that warned of overheating or other related problems would inevitably lead to a slowdown of short-term economic growth. As a result, policymakers did not act on warnings. It became clear in hindsight that doing nothing proved to be even more detrimental[34].

1.3.2. The EU supervisory system's shortcomings

The worldwide supervisory failures should not distract us from the EU specific failings. The supervisory system proved unable to cope with the integration of the financial sector. This increasing integration of the European financial sector is illustrated by the fact that over 200 cross-border banks mergers and acquisitions took place in the EU between 2000 and 2007. In the same period, euro-zone cross-border interbank loans increased from 23% to 33% of total euro-

31. Financial Services Authority, The Turner Review: A regulatory response to the global banking crisis, 2009, p. 39.
32. Group of Thirty, Financial Reform: A Framework for Financial Stability, 2009, p. 16.
33. See for example: OECD, Economic Outlook, Vol. 2007/2, No. 82, 2007; OECD, Are House Prices Nearing a Peak?: A Probit Analysis for 17 OECD Countries, OECD Economics Department Working Papers, No. 488, 2006; FED, press release on tighter standards for loans to households to avoid "predatory lending", 12 December 2001; BIS, Financial system and macroeconomic resilience, Sixth BIS Annual Conference 18-19 June 2007, BIS Papers No. 41, 2007.
34. OECD, OECD Economic Surveys: Euro Area 2010, p. 144.

zone interbank loans[35]. Already by 2005, 23% of all banking activity in Europe was considered to be of a cross-border nature[36].

While the financial sector was increasingly outgrowing national borders, supervision remained largely an affair of individual Member States. It might be possible to overcome such an asymmetry by smooth, extensive and honest cooperation. This, however, was clearly lacking. Both the quantity as well as the quality of supervisory cooperation was insufficient.

a. A lack of supervisory cooperation

The first major problem linked to European supervisory cooperation was the simple lack thereof. A number of problems hampered supervisory cooperation. First of all, cross-border cooperation was in many respects a mere supplement to supervision by the Member States. Here, the voluntary nature of such cooperation played a vital role. The home country remained firmly in control. Host state supervisors were left insufficiently involved in the supervisory decisions. Moreover, they were not able to adequately challenge the home supervisor's decision. EU mediation remained non-binding. Consequently, supervisory decisions concerning cross-border financial institutions did not need to be made in consensus. This reduced the perceived need for supervisory cooperation.

Furthermore, supervisory cooperation was hampered by differences in national financial regulation and national supervisory arrangements. While EU legislation had approximated financial regulation in many respects, it did not result in full harmonisation. Member States were often left policy options to differentiate their particular stances. Striking are the Member States' different definitions of a credit institution, as well as of regulatory capital, two core elements of financial regulation. In many other domains, regulatory differences persisted as well[37]. The differences in financial regulation created an incentive for regulatory arbitrage, i.e. financial institutions could seek the least intrusive regulatory framework. Member States who feared – or on the contrary tried to benefit from – regulatory arbitrage were inclined to limit the level of regulatory requirements[38]. There was

35. ECB, EU Banking Structures, September 2010, pp. 15-21.
36. SCHOENMAKER, D., VAN LAECKE, C., Current State of Cross-Border Banking, LSE Financial Markets Group Paper Series, Special Paper 168, November 2006, p. 8.
37. Report High-level group on financial supervision in the EU chaired by Jacques de Larosière, 25 February 2009, p. 28.
38. See: TABELLINI, G., Why did bank supervision fail?, pp. 45-47, In The First Global Financial Crisis. of the 21st Century, VoxEU Publication, Centre for Economic Policy Research, 2008, 193p., Retrievable on: http://www.voxeu.org/reports/subprime/report.pdf.

also the practice of 'gold-plating', by which Member States could introduce more strict rules if they wished so.

Differences with regard to supervision were equally present, with the structure, methods and competences of national supervisors differing considerably. Some Member States had one national supervisor, while others had four[39]. Supervisors sometimes operated independently, while others did not. The possibilities to enforce decisions made by supervisors differed as well. These differences in regulatory requirements and supervisory arrangements made cooperation among supervisors all the more difficult.

Moreover, supervisors were too often neither transparent nor honest towards one other. They were reluctant to share information, which was often compounded by confidentiality issues. There was equally a lack of openness about difficulties in national financial sectors, especially in times of crisis. This undermined mutual trust, which only made matters worse[40].

b. Failure of supervisory cooperation

Besides being too infrequent, supervisors were often unable to make swift and practicable common decisions. The non-committal nature of supervisory cooperation again played an important role. Moreover, in order to preserve Member State sovereignty, EU level supervisory bodies were only to make decisions when there was a large consensus. These rules resulted in cumbersome discussions. The consequence was often an unwieldy compromise or no agreement at all[41].

The failure of supervisory cooperation became even more apparent during the financial crisis. Because supervisory cooperation was cumbersome, national supervisors preferred national responses. The different kinds of short-selling restrictions applied by a number of Member States are a prime example[42]. The inability to agree on a common supervisory approach proved even more detrimental when supervisors had to deal with difficulties in cross-border financial institutions. Crisis management arrangements proved to be inadequate and unworkable. In most instances, national supervisors were unable to agree on

39. ECB, Recent Developments in Supervisory Structures in the EU Member States, October 2006, p. 5.
40. The de Larosière Report, op. cit. footnote 37, p. 41.
41. CEPS, Concrete Steps Towards More Integrated Financial Oversight. The EU's Policy Response to the Crisis, CEPS Task Force Report, 2008, p. 30.
42. EFC High-Level Working Group on Cross-Border Financial Stability Arrangements, Lessons from the financial crisis for European financial stability arrangements, 8 July 2009, p. 10. During the eurozone sovereign debt crisis, the same problem occurred again, as Germany unilaterally restricted short selling, see: the General Decrees of the German Federal Financial Supervisory Authority (BaFin) of 18 May 2010.

swift common action or on how to share the burden between the Member States. Even if they initially did reach an agreement, it was sometimes not abided. This was illustrated by the Fortis-case, where the initial agreement between Member States quickly fell apart and resulted in national crisis management. Such responses were far from optimal from a cross-border point of view[43].

c. *Resulting home country supervision problems*

Due to the aforementioned ineffectiveness of cross-border supervisory cooperation, the problems linked to home country supervision came to the surface. It is only logical that national supervisors are primarily concerned with securing their own national financial sector. Due to the ineffectiveness of supervisory cooperation, this led to a disregard of the situation in other Member States. Ultimately, banks were global in life, but national in death or rescue from death[44].

The most apparent problem was the inadequacy of branch supervision arrangements, clearly demonstrated by the failure of several Icelandic banks[45]. The host country supervisors in the UK, the Netherlands and other Member States had few supervisory competences over the branches of Icelandic banks. Yet, as the Icelandic banks and their branches failed, the host countries had to bear most of the costs[46].

Although less visible, supervision of subsidiaries had its own set of problems. Financial groups were inclined to centralise certain functions, such as risk and liquidity management. As a result, it often proved difficult to separate a subsidiary from the rest of the financial group. This reduced the efficiency of supervisory control[47].

43. FONTEYNE, W., et. al., Crisis Management and Resolution for a European Banking System, IMF Working Paper, WP/1070, pp. 14-15.
44. The Turner Review, op. cit. footnote 31, p. 36.
45. Iceland is a Member of the European Economic Area and its financial institutions can thus access the EU market.
46. The Turner Review, op. cit. footnote 31, p. 38.
47. EFC, Lessons from the financial crisis, op. cit. footnote 42, p. 14.

2. Overview of the Renewed EU Financial Supervisory System

In light of the above, it becomes clear that the EU's supervisory arrangements were too limited to ensure a stable and resilient financial sector. Such an ineffective financial supervisory regime is incompatible with a well-functioning internal market. As the negative effects of the financial crisis grew, so did the willingness to modify the supervisory system. This led to a set of reforms (2.1). The resulting supervisory system is in several respects significantly different from the previous one, although basic supervisory responsibilities have been left largely unchanged (2.2).

2.1. The Road towards a Renewed Supervisory System

Supervisory reforms were carried out across the globe. The G-20 provided an important impetus for these reforms[48]. In the EU, a first step towards a new supervisory system was made at the October 2007 ECOFIN council. Finance ministers then agreed on a roadmap for strengthening financial stability[49]. Nevertheless, the roadmap envisaged little in terms of major reform. It was mostly aimed at improving voluntary cooperation among supervisors, resulting in a number of changes to the supervisory arrangements[50].

The 2009 Report by the de Larosière High-level Group proved to be of more importance. The group had been mandated by the Commission President to propose measures that would establish "*a more efficient, integrated and sustainable European system of supervision*[51]". The proposed measures served as an important basis for the Commission's proposals later that year[52]. Finally, in Sep-

48. See amongst others: G-20, Declaration. Summit on Financial Markets and the World Economy, Washington, 15 November 2008 and G-20, Declaration on Strengthening the Financial System, London, 2 April 2009.
49. Annex II of Council of the European Union, Press Release of 2822nd Council Meeting, 9 October 2007, 13571/07.
50. Directive 2009/111/EC of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management, OJ L 302, 17.11.2009, pp. 97-119.
51. The de Larosière Report, op. cit. footnote 37, p. 61.
52. A communication was published in May 2009, see: COM (2009) 252 final. It was followed by a set of legislative proposals in September 2009. For macro-prudential supervision, see COM (2009) 499 final and COM (2009) 500 final. For micro-prudential supervision, see: EBA, COM(2009) 501 final; EIOPA, COM(2009) 502 final and ESMA, COM(2009) 503 final.

tember 2010, the European Parliament and the Council reached an agreement on a legislative package that redesigned the financial supervision system[53].

2.2. The Resulting Supervisory System

The reforms have fully entered into force in January 2011. As was the case before, the renewed system consists of three levels of supervisors: the EU, the cross-border and the national level. Their tasks and means of operation and cooperation have nevertheless undergone significant change.

The reforms have notably led to the creation of the European System of Financial Supervision (ESFS), which consists of both the national supervisory authorities and the European supervisors[54]. Cross-border supervisors remain outside of the ESFS, but equally play a noteworthy role in the renewed financial supervisory system. Figure 1 provides an overview.

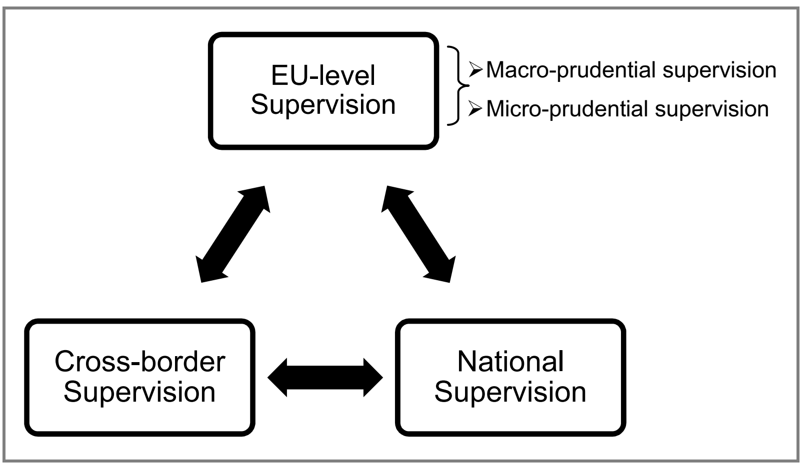

Figure 1: The EU financial supervision structure

EU level supervision has been assigned a bigger role than was previously the case. It now comprises two types of supervision. The first type is macro-prudential supervision, which aims to monitor the overall stability of the financial system and identify potential systemic risks. This task is carried out by the European Systemic Risk Board (ESRB), which is discussed in the following chapter. The second type of EU level supervision is concerned with micro-prudential

53. See: Directive 2010/78/EU, Regulations 1092/2010, 1093/2010, 1094/2010 and 1095/2010 and Council Regulation 1096/2010, OJ L 331, 15.12.2010, p. 1-164.
54. Article 1(3) of Regulation (EU) No 1094/2010, op. cit. footnote 103.

issues, i.e. the individual financial institutions. To this extent, three European Supervisory Authorities (ESAs) have been created, each responsible for a segment of the financial sector (see 4.)

At the cross-border level, the colleges of supervisors have been attributed a more significant role than was the case before the supervisory reform. A college of supervisors brings together the different supervisors of the Member States in which a given financial institution or conglomerate operates. They have been made mandatory for cross-border financial groups. This should stimulate coordination and collaboration among supervisors (see 5.1).

And finally, national level supervisory responsibilities have undergone change, albeit to a lesser degree. Notably, home country supervisors are now obliged to take into account the potential impact their decisions may have on fellow Member States. Furthermore, the concept of significant branches has been introduced, so as to reinforce cooperation between home and host supervisors. These minor changes, as well as the reinforcement of cross-border and EU supervision, have not altered the fact that home country supervisors remain in firm control of financial supervision (see 5.2).

3. EU Macro-Prudential Supervision

One of the major innovations brought about by the new supervisory set-up is the creation of the European Systemic Risk Board (ESRB), which is an EU level body responsible for macro-prudential supervision. The ESRB's mission is to prevent or at least mitigate systemic risks that threaten to disrupt financial stability. In light of the failures of pre-crisis financial supervision, such a body is much-needed.

This chapter will initially discuss the ESRB's structure (3.1), followed by an overview of its tasks (3.2) and the decision-making rules (3.3). The chapter concludes by analysing the limits of the EU macro-prudential body (3.4).

3.1. Structure

The ESRB is the sole EU level macro-prudential supervisor, but remains without a legal personality. It has a diverse internal structure, which given its lacks of binding powers, is all the more important (see infra). The ESRB comprises a General Board, a Steering Committee, a secretariat and two Advisory Committees. Figure 2 provides an overview of this structure, which is further discussed below.

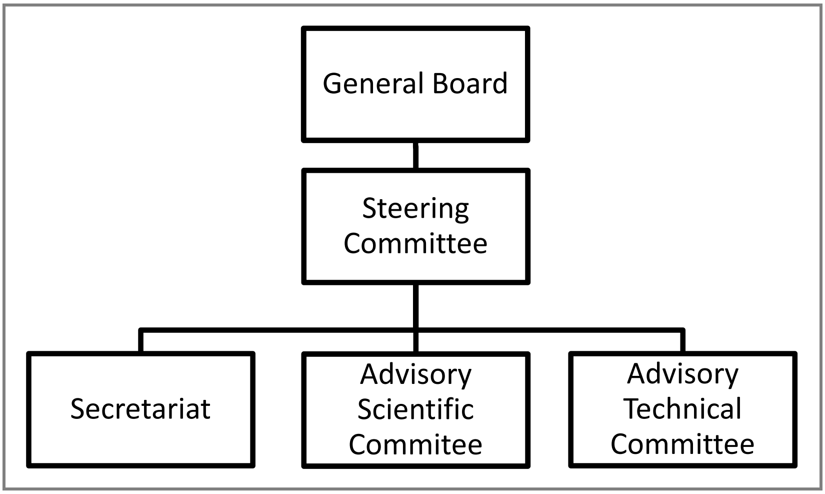

Figure 2: Structure of the European Systemic Risk Board

3.1.1. General Board

The General Board is the central decision-making body of the ESRB. It meets at least four times a year. In total, the General Board has 66 members, which can be seen as considerably large. In case of future EU enlargement, the number of members will be further increased. Of its 66 members, 37 have voting rights. The members with voting rights are:

- the President and the Vice-President of the ECB;
- the 27 Governors of the national central banks;
- a member of the European Commission;
- the Chairpersons of the three European Supervisory Authorities (see 4.);
- the Chair and two Vice-Chairs of the Advisory Scientific Committee (see infra);
- the Chair of the Advisory Technical Committee (see infra).

In addition, a representative of each Member State's relevant national supervisory authority, the President of the Economic and Financial Committee and the Head of ESRB secretariat[55] attend the meetings of the Board. They do however not have voting rights[56].

The Chair of the General Board plays a crucial role in the ESRB. During the legislative negotiations, the Parliament demanded the President of the ECB to be the Chair of the General Board, while non-eurozone countries opposed the idea. As a compromise, the President of the ECB chairs the General Board, but only during its first five years. The future review of the ESRB (set to take place in 2014 after green light from the Parliament and the Council) should lead to more permanent rules for determining the Chair[57].

As a means of counterbalancing the eurozone Chair, the election of the General Board's First Vice-Chair takes into account the need for a balanced representation between eurozone and non-eurozone countries[58], implicitly implying that the First Vice-Chair should be a non-eurozone representative[59]. The Second Vice-Chair annually rotates between the EU micro-prudential supervisory bodies' Chairpersons[60].

55. See 3.1.3.
56. Article 6 of Regulation (EU) No 1092/2010 of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, pp. 1-11.
57. Article 5(1) of ibid.
58. Article 5(2) of ibid.
59. This is indeed the case, as the Governor of the Bank of England, Mr. Mervyn King, has been elected First Vice-Chair of the ESRB. For more detail on the EU bodies' nominations, see the Annex.
60. Article 55(3) of Regulation (EU) No 1093/2010, op. cit. footnote 102.

3.1.2. *Steering Committee*

The Steering Committee is to prepare meetings and decisions of the General Board. It has 14 members with voting rights. These members are:
- the Chair of the General Board;
- the First Vice-Chair of the General Board;
- the Vice-President of the ECB;
- four other members of the General Council of the ECB (i.e. governors of national central banks or the president of the ECB);
- a member of the European Commission;
- the President of the Economic and Financial Committee;
- the Chairpersons of the three European Supervisory Authorities (see 4.);
- the Chair of the Advisory Scientific Committee (cfr. infra);
- the Chair of the Advisory Technical Committee (cfr. infra)[61].

In addition, the Head of the ESRB secretariat attends the Steering Committee's meeting[62], bringing the total number of members to 15. As the size of the General Board risks affecting its functioning, the smaller Steering Committee is likely to play a crucial role in the functioning of the ESRB.

3.1.3. *The Secretariat*

A secretariat is to support the ESRB in its administrative and analytical functioning. As of early 2011, the secretariat was comprised of more than 20 staff members[63]. Importantly, this secretariat is financed and staffed by the ECB, not the ESRB. The ECB is even authorised to appoint the Head of the ESRB secretariat. By attending all the ESRB's meeting, this person plays a crucial role[64].

The dominant role of the ECB in the secretariat clearly amplifies its role in the ESRB. For this reason, non-eurozone Member States have expressed their concern about the ESRB being disproportionately focussed on the eurozone[65].

61. Article 11 of Regulation (EU) No 1092/2010, op. cit. footnote 57.
62. See 3.1.3.
63. TRICHET, J., Introductory Statement – Hearing on the ESRB before the Committee on Economic and Monetary Affairs, European Parliament, 7 February 2011.
64. Article 3 and 4 of Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15.12.2010, pp. 162-164.
65. Treasury Committee of the UK House of Commons, Opinion on Proposals for European Financial Supervision, Session 2008-09, Sixteenth Report, 2009, pp. 19-20.

3.1.4. Advisory Committees

The General Board and the Steering Committee have two advisory committees at their disposal: the Advisory Scientific Committee and the Advisory Technical Committee. Both are to provide specific input to the ESRB, although their exact role remains murky.

The Advisory Scientific Committee is composed of 15 non-governmental experts, in addition to the Chair of the Advisory Technical Committee and the Head of the ESRB secretariat[66]. The non-governmental experts include academics, as well as representatives from the industry, trade unions and consumer organisations[67]. According to its mandate, the Advisory Scientific Committee is to review and design macro-prudential analysis and policy tools[68].

The Advisory Technical Committee for its part is a bulky body that includes over 60 public experts, i.e. a member of the Advisory Scientific Committee, the Head of the ESRB secretariat[69] and representatives of the central banks, national supervisors, the ESAs, the Commission and the Economic and Financial Committee[70]. Like the Scientific Committee, the Advisory Technical Committee is to review methodologies and policy tools. Furthermore, it is to contribute to the review of financial stability and macro-prudential policy decisions. It can equally provide opinions on EU directives[71].

3.2. Tasks

As aforementioned, the ESRB's mission is to supervise the financial system in order to prevent or mitigate systemic risk. Systemic risk is a broad concept, which the Regulation defines as "*a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy*[72]". This definition remains vague about the precise nature of a systemic risk, giving little detail on what constitutes a disruption or what separates serious negative consequences from more benign ones. This ambiguous

66. See 3.1.3.
67. Article 12 of Regulation (EU) No 1092/2010, op. cit. footnote 57.
68. ESRB, Mandate of the Advisory Scientific Committee of the European Systemic Risk Board, 20 January 2011, Retrievable on:
http://www.esrb.europa.eu/pub/pdf/ASC-mandate.pdf?b35a0459c4d622aea129dc229333cef3.
69. See 3.1.3.
70. Article 13 of Regulation (EU) No 1092/2010, op. cit. footnote 57.
71. ESRB, Mandate of the Advisory Technical Committee of the European Systemic Risk Board, 20 January 2011, Retrievable on:
http://www.esrb.europa.eu/pub/pdf/ATC-mandate.pdf?9abc3c2829b7c876cedc58f651c09d45.
72. Article 2(c) of Regulation (EU) No 1092/2010, op. cit. footnote 57.

definition might to some extent be deliberate, allowing the ESRB to adapt to future evolutions. Yet, it equally casts doubts on the exact scope of the ESRB's mission.

To perform its challenging and somewhat undefined mission, the ESRB is to carry out the following tasks: 1) supervision of the financial system; 2) emit warnings and recommendations; 3) provide follow-up on its recommendations and 4) report and interact with other supervisors.

3.2.1. Supervision

The prime task of the ESRB is to supervise and detect potential or existing systemic risk in the financial system. In order to identify whether the impairment of an element of the financial system constitutes a systemic risk, the ESRB is to take the entity's size, substitutability, interconnectedness and vulnerability into account. The Regulation stresses that every part of the financial system has the potential to be systemically important[73]. This still does not properly clarify the ESRB's supervisory scope. At any rate, assessing the importance of a risk or a financial institution is not an exact science. The ESRB therefore has some leeway when performing its supervisory task, which it will undoubtedly use.

Despite its major supervisory task, the ESRB is not allowed to perform direct supervision, i.e. demand information from individual financial institutions. It relies completely on data collected by external sources. A strict hierarchy for obtaining information has been put in place. In first instance, the ESRB is to use existing statistics available at the EU level. If this does not result in the needed information, it can request information from the ESAs and subsequently from central banks, national supervisors or national statistical authorities. If all other options prove insufficient, the ESRB can, as a last resort, request information from Member States.

Importantly, the information provided to the ESRB is to be summarized, so that it does not allow for the identification of individual financial institutions. The ESRB is only allowed to obtain information on individual financial institutions if it has received the explicit authorisation by the relevant EU micro-prudential supervisor[74]. Confidentiality of data and the willingness to avoid duplicated reporting have clearly played an important role in defining these rules. They do nevertheless make the ESRB's role all the more complicated.

73. Recital 27 of ibid.
74. Article 15 of ibid.

3.2.2. *Emitting warnings and recommendations*

If during its supervision, the ESRB finds that there is a significant risk of systemic failures or reduced resilience of the financial system (a less demanding requirement), it can emit warnings and recommendations. These are colour-coded, so as to indicate the level of urgency. Warnings and recommendations can be addressed to the EU as a whole, as well as to one or more ESAs, national supervisors or individual Member States. However, the ESRB cannot address warnings or recommendations to financial institutions[75]. In any case, the ESRB is to inform the Council and the Commission of all warning and recommendation it issues[76].

A clear limitation for the ESRB is that its warnings and recommendations are non-binding. To increase the impact of its recommendations and warnings, the ESRB can nonetheless decide to make them public. This 'name-and-shame' option should be regarded as the ESRB's ultimate weapon, only to be employed when all else fails. During the drafting of the Regulation, policymakers rightly feared that making warnings public could have unintended side effects, such as panic in the financial market. Making recommendations and warnings public has therefore been subject to more demanding decision-making rules (cfr. infra)[77]. The ability to make its messages public should by no means be viewed as a replacement for binding rules[78].

3.2.3. *Follow-up of recommendations*

An adequate follow-up of recommendations needs to compensate for the non-binding nature of the instrument. Those subject to recommendations should communicate the corrective actions they take or explain the lack thereof. This requirement is referred to as the 'act-or-explain' approach. In addition, the ESRB is to inform the appropriate bodies when it deems that insufficient measures have been taken in response to a recommendation[79].

In contrast to recommendations, no formal follow-up is foreseen for warnings. While it is true that warnings cannot strictly follow an 'act-or-explain' approach

75. Article 16 of ibid.
76. If addressed to a national supervisor, the warning or recommendation should also be transmitted to the ESAs.
77. Article 18 of Regulation (EU) No 1092/2010, op. cit. footnote 57.
78. To this extent, the Irish Broad Economic Policy Guidelines are instructive. In 2001, the Council publicly stated that it found the Irish budget to be expansionary and pro-cyclical and stated that Ireland should take actions. Despite the public nature, Ireland largely disregarded these recommendations. See: Council of the European Union, Conclusions of the 2329th Council meeting, 12 February 2001, 5696/01.
79. Article 17 of Regulation (EU) No 1092/2010, op. cit. footnote 57.

(as they do not necessarily contain specific calls for action), the lack of formal follow-up can hamper its intended impact. The effect of a warning is thus less certain and will depend even more on the subject in question's willingness to take them into account.

3.2.4. Reporting and contact with other public bodies

The ESRB is to report on its activities, both to the public and to the EU Institutions. First of all, the ESRB is required to publish an annual public report. This report should contain an analysis of financial stability, as well as all information that has been made public by the General Board. The ESRB is however not required to provide information on its non-public work, not even in an ex-post manner. This could render the core of the ESRB's work obscure to the general public, seriously hampering its public accountability.

Secondly, the ESRB has to report (in a more comprehensive manner) to the EU Institutions. The ESRB is to inform the Council and the Commission of every warning and recommendation it issues, as well as the follow-up on recommendations by the addressees, or the lack thereof.

The reporting obligations to the European Parliament are different. A number of reporting obligations are foreseen in the Regulation. The first of these stipulates that the ESRB Chair has to attend an annual hearing in the Parliament. In case of widespread financial distress, reporting should be more frequent. Secondly, the Parliament may request ad-hoc hearings of ESRB officials. Finally, the ESRB Chair is to hold at least twice a year confidential discussions with the Chair and Vice-Chairs of the Parliament's Economic and Monetary Affairs Committee (ECON)[80]. As a result, the ECON's Chair and Vice-Chairs will be substantially better informed than other parliamentarians and the private sector. This puts them in a powerful position. Despite these reporting obligations, the Parliament will be less informed on the ESRB's work than the Council and the Commission, as it is not automatically informed of ESRB warnings and recommendations[81].

Besides its reporting obligations, the ESRB is to interact with other supervisors. In the EU, it is to cooperate with the ESAs to identify and prioritise potential systemic risk. Outside the EU, it is to coordinate its work with relevant international and third country bodies[82].

80. Article 19 of ibid.
81. Article 16(3) of ibid.
82. Article 3(g-i) of ibid.

3.3. Decision-making

Normal decision-making in the ESRB's General Board consists of voting by simple majority. In addition, a quorum of two-thirds is required. However, an extraordinary meeting can be held if the General Board fails to meet this quorum. During such extraordinary meetings, decisions can be adopted with a quorum of one-third[83].

Making warnings and recommendation public is an exception to these general decision-making rules, as it requires a two-thirds majority and a fixed quorum of two-thirds[84]. Despite these majority rules, the ESRB is most likely to pursue a large consensus before emitting warnings and recommendations (see 3.4.2).

3.4. Limits

Despite the importance of the ESRB's tasks, it faces several hurdles that could prevent it from being effective. The limitations discussed below are likely to become even more important as time passes and the sensed need for effective supervision diminishes.

3.4.1. Lack of coercive power

The ESRB cannot oblige others to take its recommendations and warnings into account. It therefore constitutes a soft law body. Such bodies can be influential, but national, regional and international examples show that this is challenging[85].

The ESRB has some strong points when drawing comparisons with other soft law bodies. For example, it is part of the EU, which has binding powers – in contrast to many international organisations. It furthermore has some means of stimulating compliance, notably through the 'act-or-explain' approach and its powers to publicly name and shame. Finally, EU Institutions and national supervisors have the obligation to cooperate with the ESRB[86]. If they fail to do so, this can be viewed as a violation of their obligations under EU law[87].

83. Article 10 of ibid.
84. Article 18(1) of ibid.
85. See FERRAN, E., KERN, A., Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board, Working Paper Series, November 2010, Retrievable on: http://ssrn.com/abstract=1676140.
86. Article 15 (1) of Regulation (EU) No 1092/2010, op. cit. footnote 57.
87. FERRAN, E., KERN, A., Can Soft Law Bodies be Effective?, op. cit. footnote 86, pp. 30-31.

Even so, these strengths are on their own unlikely to sufficiently ensure any meaningful influence. In the end, the ESRB is to rely for a major part on its reputation, instead of on coercive powers. As a consequence, the ESRB will continuously need to labour for its voice to be heard.

3.4.2. A more than challenging task

It's clear that the ESRB faces a daunting task. Whether deliberate or not, its mandate remains vague. This leaves some important questions unanswered. It is not clear whether the ESRB's mission entails supervision of the financial sector as such or whether it is to take into account other macro-economic evolutions, most notably asset prices. Moreover, the ESRB's role in crisis situations has not been determined, despite insistence by the Economic and Financial Committee[88].

Even with a better-defined mandate, the ESRB's task would be challenging – especially if we take into account the ESRB's other limits. In essence, the ESRB risks failing to perform its core tasks in the two ways. On the one hand, it may fail to warn of a systemic risk. To this extent, many of the problems with regard to the former supervisory system remain present after the reforms: providing an assessment of macro-prudential risk remains an intellectually challenging task and policymakers will continue to be doubtful of warnings that could undermine short-term growth. On the other hand, the ESRB could fail its tasks by erroneously identifying a situation as posing a systemic risk.

As aforementioned, supervision is not an exact science and hence entails an element of uncertainty. Therefore, the two types of mistakes are to some extent unavoidable. While erroneous warnings might seem less harmful than failing to warn of a systemic risk, multiple erroneous warnings could undermine the ESRB's reputation and thus its relevance[89].

3.4.3. Sizeable General Board: balancing consensus and substance

The size of the General Board renders the work of the ESRB even more complicated. It is unmistakably difficult to discuss macro-prudential matters with 66 participants around the table. This is especially true given that the ESRB dis-

88. EFC, Lessons from the financial crisis, op. cit. footnote 42, p. 11.
89. SMAGHI, L., Speech at the CEPR/ESI 13th Annual Conference on 'Financial Supervision in an Uncertain World', European Banking Center at Venice International University, Venice, 25-26 September 2009, Retrievable on: http://www.ecb.int/press/key/date/2009/html/sp090925.en.html

cusses sensitive, confidential matters. The former EU supervision bodies proved to be inappropriate forums for exchanging information, due to their broad membership[90]. Yet, under the current structure, the EU is certain to repeat previous mistakes. There is a real risk that the functioning of the ESRB will be hampered as a consequence[91].

Besides difficulties in exchanging information, the size of the General Board will also make it more difficult to agree on evocative warnings. Here, the ESRB faces a considerable dilemma. If its messages are to have a reputational effect, it should adopt texts with a large consensus. When warnings or recommendation lack consensus inside the Board, their validity can easily be questioned. On the other hand, a consensus among so many participants is likely to lead to watered-down texts, rendering them less meaningful. For the ESRB, it will be a difficult to deliver documents that are both consensual and substantive.

3.4.4. Strong reliance on central banks

While the ESRB's membership is inclusive in terms of Member State representation, it is less so in sectoral terms. The ESRB is dominated by central bankers and the role of non-central bank supervisors has as a consequence been limited considerably. In the General Board, more than three out of the four voting members are central bankers. Furthermore, the large role of the ECB in the functioning of the ESRB strengthens central banks' presence. The need for a balanced territorial representation seems to have been detrimental to both the size of the General Board and the sectoral representation inside the ESRB. Other bodies that carry out macro-prudential supervision are less dependent on central bankers. The international Financial Stability Board for example has a wider range of members, including finance and economy ministries[92].

The lack of diverse sectoral representation can hinder the ESRB's ability to detect and respond to systemic risks. While central bankers have useful information and knowledge, they lack expertise in certain fields and do not bear responsibility for financial sector crisis management[93].

Equally worrying is the fact that financial stability can conflict with central bankers' main objective: inflation targeting. For example, tighter monetary pol-

90. EFC, Lessons from the financial crisis, op. cit. footnote 42, p. 11.
91. SIBERT, A., Systemic Risk and the ESRB, European Parliament Note, 2009, p. 6.
92. See: FSB Member Institutions, Retrievable on: http://www.financialstabilityboard.org/members/links.htm.
93. Treasury Committee of the UK House of Commons, Opinion on Proposals for European Financial Supervision, Session 2008-09, Sixteenth Report, 2009, pp. 18-19.

icy might be advantageous for inflation reduction, but it could also run the risk of undermining financial stability. Conversely, providing liquidity to distressed financial institutions may stabilise the financial system, but it can also lead to rising inflation[94]. This conflict of interest could potentially lead to Board members neglecting their responsibilities as members of the ESRB's General Board, which is for most of them after all only a secondary responsibility.

3.4.5. Legal issues

The legal basis for the creation of the ESRB is contained in Article 114 TFEU. This article allows for "*measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market*". A legislative act based on Article 114 TFEU hence needs to fulfil two requirements:

1. it needs to contribute to the approximation of Member State provisions and
2. it should contribute to the internal market.

Regarding the latter requirement – 'to contribute to the internal market'-, the Court of Justice of the European Union has shown some leniency in past cases. The Court has allowed the use of article 114 TFEU, even if other objectives than the mere good functioning of the internal market were unmistakably present[95].

In case of the ESRB, the Regulation stipulates that "*[t]he ESRB should contribute to the financial stability necessary for further financial integration in the internal market*[96]". It seems more than likely that the Court of Justice would accept that the ESRB does indeed contribute to the functioning of the internal financial services market, as well as the internal market as a whole. This condition consequently does not seem to pose a problem.

With regard to the required approximation of Member State legislation, the situation is less evident. The Court of Justice has – once more – interpreted this requirement with a certain degree of flexibility. The approximation of Member State provisions does not imply that the legislative act should only be addressed to the Member States. Hence, a regulation (which is the legal instrument used

94. DE GREGORIO, J., Recent challenges of inflation targeting, pp. 9-13, In: Perspectives on inflation targeting, financial stability and the global crisis, BIS Papers No 51, March 2010.
95. See for example Case C-217/04 where the Court of Justice accepted the creation of a European Network and Information Security Agency and Case C-380/03 on the prohibition of advertising and sponsorship of tobacco products in the printed press and broadcasting. In both cases, the Court accepted Article 114 TFEU as a legal basis, although improving the internal market was just one of the objectives. For more detail, see: GUTMAN, K., Case C-66/04, Smoke Flavorings; Case C-436/03, SCE; & Case C-217/04, ENISA, Columbia Journal of European Law, Winter 2006/2007.
96. Recital 31 of Regulation (EU) No 1092/2010, op. cit. footnote 57.

for the ESRB) can indeed be based on Article 114 TFEU. In addition, the legislative act itself does not need to harmonise rules. The Court has accepted that Article 114 TFEU can be used to create an EU body that merely contributes to the harmonisation of Member State provisions, without doing so itself[97].

Notwithstanding, it is uncertain whether the ESRB Regulation even indirectly contributes to the approximation of Member State provisions. The ESRB's Advisory Committees do to some extent have a role in approximating Member State provisions, but this role was not provided for in the ESRB Regulation. Although the Court has shown leniency, it equally stated that the contribution to the approximation of market conditions needs to be substantial, going beyond a mere "*incidental effect*[98]". The act should equally alter the normative content of Member State provisions[99]. Here within lies the potential contradiction of the ESRB Regulation with EU law. It is unclear how the ESRB alters the content of Member State provisions, as it isn't the ESRB's objective, nor is it endowed directly or indirectly with the competences to do so.

It is therefore a possibility that the Court of Justice would reject the ESRB's legal basis were the matter brought to court. However, this problem is not likely to arise in the near future. There was a large consensus among Member States and in the European Parliament on the creation of such a body. Furthermore, the ESRB cannot directly address financial institutions, limiting the likelihood that financial institutions would question the ESRB's legality. Nevertheless, legal actions against the ESRB are not excluded in the long-term. This can especially be the case if the ESRB proves to play an important role, in which case its actions would undoubtedly be closely scrutinised by the financial sector.

Were the legal basis of the ESRB successfully challenged, different options would be available in order to re-create an EU macro-prudential supervisor. Firstly, a new supervisor could be based on Article 352 TFEU. This legal basis requires unanimity by the Council, which could potentially lead to a more limited EU macro-prudential supervisor. A second option would be to base it on Article 127(5) or Article 127(6) TFEU. In this case, macro-prudential supervision would be conducted by the European System of Central Banks, a requirement which could run into opposition from non-eurozone Member States. It

97. Paragraph 44 of Judgment of the Court (Grand Chamber) of 2 May 2006, United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union, Case C-217/04, European Court reports 2006 Page I-03771.
98. Paragraph 35 of Judgment of the Court (Sixth Chamber) of 18 November 1999, Commission of the European Communities v Council of the European Union, Case C-209/97, European Court reports 1999 Page I-08067.
99. Article 28 of Judgment of the Court of 9 October 2001, Kingdom of the Netherlands v European Parliament and Council of the European Union, Case C-377/98, European Court reports 2001 Page I-07079.

would equally exclude supervision of insurance undertakings, which might prevent the supervisor from having a broad and encompassing view. Finally, the new EU macro-prudential supervisor could continue to be based on Article 114 TFEU, but with the clear goal of approximating Member State provisions.

The failure to create a new macro-prudential supervisory body in the event of a successful legal challenge would undermine the stability of the European financial system. While in the current climate, it is widely accepted that EU macro prudential supervision is required, this may not be the case in the future. When the effects of the financial and economic crisis will be less tangible, concern over the safety of our financial system will gradually decline, as will the perceived need for financial supervision. For this reason, the legal basis should be an important element for any subsequent review of the ESRB.

4. EU Micro-Prudential Supervision

While macro-prudential supervision is an important aspect of supervision, it can by no means replace the supervision of individual financial institutions, referred to as micro-prudential supervision. Such supervision constitutes the first line of defence against any financial sector difficulties. Mirroring the discussion on macro-prudential supervision, this chapter begins with an overview of the structure of EU micro-prudential supervision (4.1), followed by a discussion of its tasks (4.2) and decision-making rules (4.3). The chapter concludes by focussing on the limits of EU micro-prudential supervision (4.4).

4.1. Structure

The micro-prudential arm of EU level supervision is not carried out by a single institution, but rather by a set of EU bodies. In order to understand how it functions, we need to look at its overall structure, as well as the internal configuration of the main EU micro-prudential supervisory bodies, i.e. the European Supervisory Authorities (ESAs). This renewed structure builds to a large extent upon the previous supervisory set-up.

4.1.1. Overall structure

At the EU level, micro-prudential arrangements comprise three European Supervisory Authorities, a Joint Committee of ESAs and a Board of Appeal. Figure 3 provides an overview.

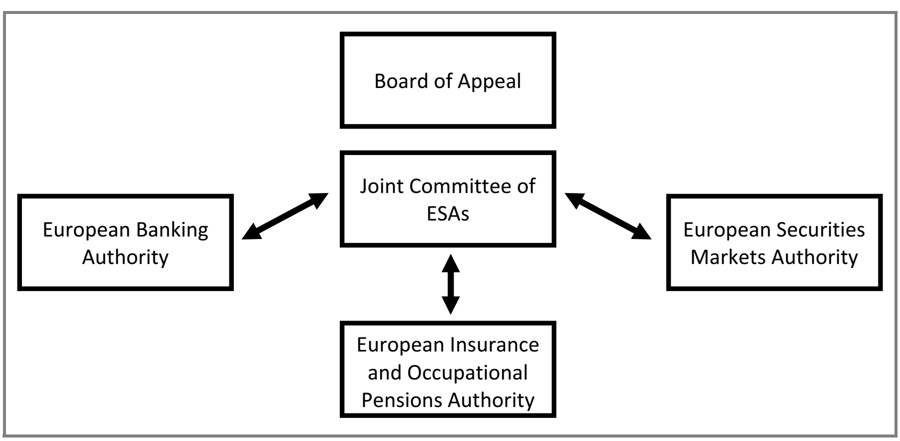

Figure 3: Structure of EU micro-prudential supervision

The most important elements of this structure are the three ESAs, which replace three former Lamfalussy level 3 Committees[100]. Each of the ESAs deals with a specific subset of the financial sector, namely:

- the European Banking Authority (EBA): responsible for the banking sector[101];
- the European Insurance and Occupational Pensions Authority (EIOPA): responsible for the insurance and occupational pensions sector, including pension funds[102];
- the European Securities and Markets Authority (ESMA): responsible for the securities sector and financial markets[103].

The ESAs are set up as EU agencies[104] and are endowed with a legal personality[105]. This allows them to exercise a certain degree of independence from the EU Institutions[106]. Agreeing upon the ESAs' location proved to be a major point of contention during the legislative discussions. Eventually, it was decided that the ESAs' headquarters should remain at the same location as the former Lamfalussy level 3 Committees. As a result, the EBA is located in London, the EIOPA in Frankfurt and the ESMA in Paris[107]. These arrangements will be the subject of a review, due to be completed in 2014.

The Joint Committee of ESAs deals with cross-sectoral issues, as well as financial conglomerates. It equally plays an important role in interacting with the ESRB. It consists of representatives of the three ESAs and is chaired on a rota-

100. See 1.2.2.
101. See Article 1(2-3) of Regulation (EU) No 1093/2010 of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, pp. 12-47, hereinafter EBA Regulation.
102. See Article 1(2-3)Regulation (EU) No 1094/2010 of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, pp. 48-83, hereinafter EIOPA Regulation.
103. See Article 1(2-3) of Regulation (EU) No 1095/2010 of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, pp. 84-119, hereinafter ESMA Regulation.
104. The Regulations themselves avoid using the word agency. In preparatory work of the Institutions, the ESAs have however been described as such. See for example Annexe II of European Commission, Proposal for a regulation establishing a European Insurance and Occupational Pensions Authority (EIOPA) of 23 September 2009, COM(2009) 502 final. In addition, the Vacancy Notices for ESA posts indicates that the ESAs are agencies, see for example: Vacancy Notice – Chairperson (Grade AD 15) – European Supervisory Authority – European Securities and Markets Authority (ESMA) – COM/2010/10291, OJ C 290A, 27.10.2010, pp. 17-20.
105. Recital 14 of EBA and ESMA Regulations, op. cit. footnote 102-103 and Recital 13 of EIOPA Regulation, op. cit. footnote 104.
106. ANDOURA, S., TIMMERMAN, P., Governance of the EU: The Reform Debate on European Agencies Reignited, EPIN Working Paper, nr. 19, 2008, p. 5.
107. Article 7 of EBA Regulation, op. cit. footnote 102, of ESMA Regulation, op. cit. footnote 103 and of EIOPA Regulation, op. cit. footnote 104. Hereinafter these three Regulations are referred to as ESA Regulations.

tional basis by the ESAs' Chairs[108].The Joint Committee is the successor of former so-called 3L3 arrangements amongst the Lamfalussy Level 3 Committees.

Given the significant role of the ESAs, a common Board of Appeal has been established. This Board of Appeal aims to allow for a timely contestation of ESA decisions, preceding an often cumbersome procedure before the European Court of Justice. It comprises six members. Each ESA is to nominate two members of the Board of Appeal from a shortlist provided by the Commission[109]. Any person to which an ESA decision is addressed or who is directly and individually affected by the decision may appeal to the Board[110], which can subsequently confirm or invalidate an ESA decision[111]. The decisions made by the Board of Appeal can be contested before the European Court of Justice[112].

4.1.2. Internal organisation of the European Supervisory Authorities

The internal structure of the three ESAs is practically identical. They each comprise at a Chairperson, an Executive Director, a Board of Supervisors, a Management Board, a Committee on financial innovation and a platform for stakeholder input. Other bodies, such as working groups, can equally be created, but are not required by the Regulations.

The **Chairperson** is to be a full-time professional, which implies that the person cannot combine his function with any other supervisory or industry functions. The Chair heads the meetings of the Board of Supervisors and the Management Board (see infra), but only has voting rights in the latter. He is appointed by the Board of Supervisors for a five year period. The European Parliament can object to this nomination, although the consequences of such an objection are not specified in the Regulations[113].

An **Executive Director** is in charge of the daily management of the ESA. Like the Chairperson, the director is a full-time professional, without any other positions in government or industry. He prepares the meetings of the Management Board

108. See Section 1 of Chapter IV (Articles 54-57) of ESA Regulations, op. cit. footnotes 102-104.
109. See Section 2 of Chapter IV (Articles 58-59) of ESA Regulations, op. cit. footnotes 102-104.
110. In principle, an appeal does not have a suspending effect, unless decided otherwise by the Board of Appeal.
111. Article 60 of ESA Regulations, op. cit. footnotes 102-104.
112. Article 61 of ibid.
113. Articles 48-50 of ibid.

and is also charged with drafting the work programmes and designing and implementing the ESA's budget[114].

The **Board of Supervisors** is the main decision-making body of each ESA. Its members with voting rights are the heads of the relevant national public authorities[115]. The Commission, the ECB, the ESRB and the two other ESAs each have a representative present in the Board of Supervisors, all without voting rights. Finally, the ESA's Executive Director and the Chairperson participate in the Board's meetings, equally without voting rights[116]. In a Union of 27, the Board consists of 34 members.

The meetings of the Board of Supervisors are prepared by the **Management Board.** The Management Board's members with full voting rights are the ESA's Chairperson and six national supervisors. Furthermore, a Commission representative participates in its meetings, but is only allowed to vote in matters that concern the establishment of the ESA's budget. Finally, The Executive Director equally attends the Management Board, but has no voting rights. In total, the Management Board has nine members. It therefore is a select group in which preliminary decisions can be taken with relative ease[117].

The relevant Regulations equally stipulate that each ESA has a **Committee on financial innovation**. The Committee comprises representatives of all relevant national supervisory authorities. It should focus on achieving a coordinated approach to the treatment of new financial activities[118]. This is of major importance. Yet, the ESAs will have to define the Committee's role more precisely if it is to properly carry out this function.

Finally, **Stakeholder Groups** serve as a platform for consultation with and input from interested parties. The EBA and the ESMA each have one Stakeholder Group at their disposal, while the EIOPA has two[119]. Each Stakeholder Group is composed of 30 members, consisting of academics and representatives from the financial sector, their employees and consumers[120]. Their input is somewhat similar to that of the ESRB's Advisory Technical Committee.

114. Articles 51-53 of ibid.
115. If a Member State has multiple relevant public authorities, it should agree on a common representative.
116. Articles 40-44 of ESA Regulations, op. cit. footnotes 102-104.
117. Articles 45-47 of ibid.
118. Article 9(4) of ibid.
119. For the EBA, this is the Banking Stakeholder Group; For the ESMA, this is Securities and Markets Stakeholder Group; for the EIOP, the two Stakeholder groups are: the Insurance and Reinsurance Stakeholder Group and the Occupational Pensions Stakeholder Group.
120. Article 37 of ESA Regulations, op. cit. footnotes 102-104.

4.2. Tasks

Before discussing the European micro-supervisory bodies' tasks, it is important to indicate what they are not to do. The ESAs are not mandated to carry out day-to-day supervision of financial institutions, which is the sole responsibility of national supervisors[121].

The ESAs nevertheless have a wide range of tasks to fulfil. As will become clearer in further discussion, the ESAs' actual powers vary considerably from task to task. In many fields, its tasks are limited to soft law instruments and are thus non-binding. In other fields, the ESAs are competent to take decisions that are binding upon others – although these decisions can be challenged.

Currently, the three ESAs have almost identical tasks. However, the ESMA will be given additional supervisory responsibilities, as well as the power to ban certain financial activities if needed (see infra). In the future, the other ESAs are likely to be attributed new competences as well, suggesting that the ESAs' roles are likely to diverge over time.

4.2.1. Supervision

Although the ESAs are not to conduct daily supervision, they are tasked with some supervisory tasks. They are notably to **monitor market developments** of the market segment they supervise (e.g. the European Banking Authority monitors the banking sector)[122]. In addition, they are to keep an eye on systemic risk[123]. Both should provide an input for the ESRB.

The ESAs equally have an important role to play in **stress tests**, i.e. the assessment of the resilience of financial institutions to adverse market developments[124]. While the ESAs are not tasked to conduct stress tests, they are responsible for *initiating and coordinating* them. Such involvement of the ESAs is aimed at increasing the coherence and credibility of EU stress tests. Previous stress-tests, and in particular the July 2010 stress test, were seen as lacking in trans-national consistency, hampering their quality and credibility. Mere EU coordination alone will however not be sufficient to achieve the sought-after results. Such results crucially require simulating severe stress situations, as well

121. Recital 9 of EBA and ESMA Regulations, op. cit. footnote 104-105 and Recital 8 of EIOPA Regulation, op. cit. footnote 106.
122. Article 32(1) of ESA Regulations, op. cit. footnotes 102-104.
123. Article 22 of ibid.
124. Article 32(2) of ibid.

as openness on the results. It is doubtful whether future stress tests will meet these requirements[125].

The way the ESAs are to **collect information** for their supervisory tasks is set out by the Regulations[126]. ESAs are to first take into account information available at the EU level, then request data from national supervisors and subsequently from the Member States' other public bodies. The ESA is only allowed to request data from individual financial institutions if none of these other sources provide the required information.

In addition to the aforementioned role that ESAs play regarding general supervision, the ESMA is set to become responsible for **direct supervision of specific financial actors**. This notably includes credit rating agencies[127]. The Commission equally proposed supervision of derivative trade repertories by the ESMA[128]. These limited supervisory competences could be a starting point for increased micro-prudential supervision at the EU level. Nonetheless, such European supervision remains at present a distant prospect, as Member States currently retain firm control of their own financial supervision.

4.2.2. Developing a single EU rule book

A major goal of the ESAs is to work towards a single EU rule book[129]. The ESA Regulations themselves do not define what this concept actually entails. The Council of Ministers described the single rule book as "*a core set of EU-wide rules and standards directly applicable to all financial institutions active in the Single Market*[130]". Still, the scope of such a core set remains unclear. It therefore leaves the ESAs some room for interpretation, but can equally lead to disagreement between supervisors. In any case, a single rule book does not imply a complete harmonisation of all rules applicable to financial institutions. All the same, it should lead to less divergent financial legislation across Member States. This is to result in less regulatory arbitrage opportunities and reduced gold-plating issues (see 1.3.2). The ESAs have two instruments at their disposal to achieve these objectives.

125. VERON, N., EU Financial Regulatory Reform: A Status Report, Bruegel Policy Contribution, Issue 2010/11, December 2010, p. 2.
126. Article 35 of ESA Regulations, op. cit. footnotes 102-104.
127. European Commission, Proposal for a Regulation on amending Regulation (EC) No 1060/2009 on credit rating agencies, 2 June 2010, COM(2010) 289 final.
128. European Commission, Proposal for a Regulation on OTC derivatives, central counterparties and trade repositories, 15 September 2010, COM (2010) 484 final.
129. Recitals 5 and 22 of EBA and ESMA Regulations, op. cit. footnote 104-105 and Recital 5 and 21 of EIOPA Regulation, op. cit. footnote 106.
130. Council of the European Union, Agreed Council conclusions on Strengthening EU Financial Supervision, 10 June 2009, 10862/09, p. 5.

Firstly, the ESAs can **adopt non-binding guidelines and recommendations**[131]. The ESAs can address these guidelines and recommendations to both national supervisors and individual financial institutions. Supervisors and financial institutions should make every effort to comply. In case of inaction, supervisors have to provide adequate justification. For financial institutions, reporting on the implementation is only obligatory when explicitly required by the guideline or recommendation. These measures are to increase compliance. It does however not take away the fact that the guidelines and recommendations have no binding effects, exposing them to the same weaknesses as the former Lamfalussy level 3 Committees.

Secondly, the ESAs **develop draft binding technical standards**[132], including both regulatory and implementing standards. The latter relate to standards that need to ensure uniform implementation of EU legislation, without amending the legislation. Regulatory technical standards on the other hand do supplement or amend a legislative act, but only those elements which are non-essential[133].

The ESAs' technical standards subsequently need to be formally endorsed by the Commission. The power of the Commission to draft its own technical standards is limited. It may only do so when an ESA has not submitted adequate drafts within the established time frame. This offers the ESAs some additional power.

The European Parliament and the Council can object to a technical standard within the proceeding three months following its adoption by the Commission. It remains to be seen whether these institutions will be able to evaluate delegated acts within such a limited time frame. The Parliament in particular may struggle to operate on such a tight schedule. At any rate, the difficult balance between the ESAs' independence and accountability should be closely monitored.

As such, both the draft technical standards and the guidelines and recommendations are non-binding. However, the drafts do become legally binding instruments and are directly applicable to financial institutions once the Commission endorses them. Only in rare cases would the Commission not endorse such a draft. As a consequence, the draft technical standards will have a bigger impact on the harmonisation of financial legislation than the guidelines and recommendations. All the same, neither excludes gold-plating nor regulatory arbitrage.

131. Article 16 of ESA Regulations, op. cit. footnotes 102-104.
132. Article 10-15 of ibid.
133. Articles 290-291 TFEU, op. cit. footnote 15.

4.2.3. Enforcing EU rules

Not only do the ESAs play a crucial in working towards a single rule book, they also have substantial competences to ensure the enforcement of EU rules. An initial way to enforce EU-rules consists of **counteracting breaches of EU law** by national supervisors[134]. The ESAs must follow a specific procedure. Firstly, an ESA has the right to investigate the alleged breach of EU law. Subsequently, it can recommend action to a national authority. If this does not lead to satisfactory results, the Commission can issue a formal opinion on the matter. If the supervisor's actions are still considered to be insufficient after this formal opinion, the ESA can require financial institutions to act. It can however only do so if 1) the EU legislation in question is directly applicable to financial institutions (notably regulations and technical standards) and 2) the ESA's actions are either needed to maintain the conditions of competition in the market or to ensure the stability of the financial system.

As a second means of enforcing EU rules, the ESAs have an active role in **settling disagreements between national authorities**[135]. After an initial conciliation phase, an ESA is empowered to take decisions that bind national authorities. If national authorities still do not comply, the ESAs can take decisions addressed to financial institutions. These decisions override decisions made by other supervisors.

Both in counteracting breaches of EU law and the settling of disagreements, the ESAs' actions are only to ensure compliance with EU law. This limits the scope of these competences. Even so, it is to be underlined that the ESAs' binding powers in the matter imply a significant step-up in the role of EU level supervisors.

4.2.4. Preparing for and dealing with distress in the financial system

Moments of financial distress are unavoidable, even if the most stringent of rules are in place. Competences have been conferred upon the ESAs that aim to improve the handling of such situations and which should avoid the lack of supervisory cooperation, as occurred during the financial crisis.

In the first place, the ESAs are to play a role in **contingency planning.** This includes recovery, resolution and funding arrangements[136]. Contingency plan-

134. Article 17 of ESA Regulations, op. cit. footnotes 102-104.
135. Article 19-20 of ibid.
136. Articles 25-27 of ibid.

ning should allow policymakers to deal with the failure of a financial institution without upsetting financial stability or requiring public bailouts. The ESAs are not to set out the basic rules, as this shall be done in the form of a legislative act. To this extent, the Commission is to make a (not so ambitious) proposal in the first half of 2011[137]. Once the legislative act is adopted, the ESAs will be able to review the arrangements and adopt draft technical standards on the matter. It can equally contribute to concrete arrangements among supervisors. Such arrangements are without doubt useful and already existed before the financial crisis. Yet, they proved very difficult to abide, resulting in national responses.

To counter national retrenchment in cases of crises, the Council can declare an **emergency situation** during which the ESAs would be able to exercise **supplementary powers**[138]. The Council may decide to declare an emergency situation if developments threaten the proper functioning of the financial markets or the financial system[139]. When such a situation is declared, the ESAs have the power to require actions by national supervisors. If a national supervisor does not act sufficiently, the ESAs can adopt decisions addressed to individual financial institutions. In this instance, the ESA's decision would prevail over decisions taken by the national supervisors. It should be remembered however that an ESA can only address its decision to individual institutions if there is an incorrect application of directly applicable EU legislation by the competent authorities.

In specific cases, the ESAs are able to temporarily **restrict or ban financial activities** if these pose a threat to the financial system or its markets[140]. This is frequently believed to be the case when investors speculate massively on deteriorating market situations. The competence of the ESAs in this matter needs to reduce the likelihood of unilateral restrictions, as witnessed during the financial crisis. The extent of the ESAs' competences depends on whether an emergency situation has been declared. If the Council hasn't declared an emergency situation, the ESAs only have the power to restrict or ban financial activities when European legislation explicitly permits doing so. This is not yet the case, but could change as the Commission has proposed to endow the ESMA with the power to temporarily prohibit short selling and uncovered credit default swaps[141]. If the Council has declared an emergency situation, the ESAs would

137. According to its 2010 Communication, the Commission is to propose rules that apply only to credit institutions and systemically important investment banks. Cross-border cooperation would remain largely voluntary. See: European Commission, Communication on an EU Framework or Crisis Management in the Financial Sector, 20 October 2010, COM(2010) 579 final.
138. Article 18 of ESA Regulations, op. cit. footnotes 102-104.
139. The ESAs and ESRB can issue a confidential warning to the Council stating that an emergency situation may arise. See also: Article 3(2)e of Regulation (EU) No 1094/2010, op. cit. footnote 54
140. Article 9(5) of ESA Regulations, op. cit. footnotes 102-104.
141. European Commission, Proposal for a Regulation on Short Selling and certain aspects of Credit Default Swaps, 15 September 2010, COM(2010) 482.

yield considerably more power. In this instance, it has the ability to prohibit any kind of financial activity. In either case, the Regulations do not impede Member States from unilaterally restricting financial activities. This leaves the door open for national solutions when national supervisors are not able to agree on a common approach.

Despite the ESAs' tasks and the future EU crisis management rules, the matter will still largely remain in the hands of national policymakers. Only they will be able to take measures with a significant fiscal impact (see 4.4.3). Cooperation has certainly been facilitated, but a coordinated approach will remain most challenging.

4.2.5. Advancing supervisory cooperation and convergence

The previous Lamfalussy level 3 Committees were for a major part aimed at improving cooperation among national supervisors and aligning their practices. The ESAs have inherited this role from these Committees, as they are to work towards a **common supervisory culture**[142]. This is a means of increasing supervisory cooperation in a soft way. However, the non-binding nature limits the potential impact of these instruments.

The ESAs' task of advancing supervisory cooperation and convergence comprises **facilitating the exchange of information** between supervisors[143] and **peer review** of supervisory practices[144]. The ESAs are equally to provide **non-binding mediation**[145] between national authorities – although they have binding powers in case mediation fails (see supra).

Promoting and monitoring colleges of supervisors (see 5.1) is another way to promote supervisory cooperation[146]. Of notable importance is the fact that the ESAs can participate in the activities of colleges of supervisors. The ESAs are full members of the colleges of supervisors, not just observers as was initially proposed. Moreover, the ESAs can demand further discussions when it finds a college of supervisors' decision inadequate. Yet, the ESAs do not have any binding powers when it comes to decision-making in the colleges.

Finally, the ESAs are to facilitate and stimulate the **delegation of tasks** between national supervisors, whereby one national supervisor takes over certain tasks

142. Article 29 of ESA Regulations, op. cit. footnotes 102-104.
143. Article 29(1)b of ESA Regulations, op. cit. footnotes 102-104.
144. Article 30 of ibid.
145. Article 17 of ibid.
146. Article 21 of ibid.

of another supervisor[147]. The provisions are of a voluntary nature, but could be a step towards altering home country supervision. Nevertheless, even in the case of delegated tasks, the home country supervisor continues to hold final responsibility.

4.2.6. Consumer protection

On the insistence of the European Parliament, the ESAs have been attributed some responsibilities with regard to consumer protection. The ESAs' competences involve consumer protection in the narrow sense, as well as national guarantee schemes aimed at protecting the public against unforeseeable events.

The ESAs play a role in the **protection of consumers dealing with financial products**. The ESAs have many channels to pursue this goal, including coordinating financial education initiatives, developing training standards for the financial sector and helping to develop common disclosure rules. They can equally adopt guidelines and recommendations to this extent. They again do not possess any binding powers in the matter[148].

The fact that ESAs' have been attributed a role with regard to national **guarantee schemes** is a consequence of these schemes' prior inadequacies. The crisis notably illustrated that the schemes' coverage was rather low and that the levels of coverage differed considerably between Member States. EU initiatives to try to overcome these shortcomings are underway, although subject to serious debate[149]. The ESAs are to contribute to an EU-wide coherent implementation of these future rules, as well examine and improve their general functioning[150].

147. Article 27 of ibid.
148. Article 9 of ibid.
149. See: European commission, Proposal for a Directive …/…/EU on Deposit Guarantee Schemes [Recast], 12 July 2010, COM(2010)368 final; European Commission, Proposal for a Directive amending Directive 97/9/EC on investor compensation schemes, 12 July 2010, COM(2010) 371 final and European Commission, White Paper on Insurance Guarantee Schemes, 12 July 2010, COM(2010) 370.
150. Article 26 of ESA Regulations, op. cit. footnotes 102-104. Each ESA is to focus on a specific type of scheme. The EBA is to contribute to deposit guarantee schemes, the ESMA to investor compensation schemes and the EIOPA to insurance guarantee schemes. With regard to the former two (deposit and investor guarantee schemes), the EBA and the ESMA may adopt guidelines and recommendations, as well as technical standards. As insurance guarantee schemes are less common in the Member States, the EIOPA is only to help assess whether an EU system is required in this domain.

4.2.7. Reporting and contact with other public bodies

With the increased competences come increased reporting obligations. As for the ESRB, reporting and interaction with other supervisory bodies have been specified in the Regulations.

As for the general public, the ESAs are to publish an annual **public report** on their activities. The report needs to provide information on the segment of the financial industry which they supervise. It should furthermore include information on the ESA's guidelines and recommendations, including the level of compliance by the Member States. It shall equally detail which supervisors have not acted upon the ESA's actions to counter breaches of EU law[151]. The report is to a certain extent to serve as a 'name-and-shame' instrument.

The ESAs are to **report to the European Institutions** in a more rigorous manner. This is reflected in a dialogue between the ESAs and the Institutions. At any time, the Parliament and the Council may request a statement by an ESA Chairperson. The Chairperson is also to respond to questions of the Members of the European Parliament. Furthermore, the ESAs are to provide the European Parliament with all relevant information[152].

With regard to **contact with** other **supervisory bodies**, the relation with the European Systemic Risk Board is of prime importance. Communication between the bodies is to be a two-way street. The ESAs are to warn the ESRB on potential systemic risks, while they equally need to act upon warnings and recommendations given by the ESRB[153]. Besides the ESRB, the ESAs may also engage in contact with international and third country bodies, although these contacts are not to create legal obligations[154].

Finally, in its work, the ESAs are to **consult** with **interested parties**. The network of interested parties has been formalised through Stakeholder Groups. These Groups have to be consulted when an ESA plans to adopt draft technical standards, guidelines and recommendations[155].

151. Article 43(5) of ibid.
152. Article 50 of ibid.
153. Article 36 of ibid.
154. Ibid.
155. Article 37 of ibid.

4.3. Decision-making

As a general rule, decisions by the Board of Supervisors are taken by a simple majority of its members. In a Union of 27, this implies that a decision can be passed when supported by 14 national supervisors. The Regulation has not specified quorum rules. It is left to the ESAs to define these as they see fit[156].

Multiple exceptions to the general voting rule have been put in place. Table 1 provides an overview of this. A qualified majority is needed in order for decisions with regard to more comprehensive competences, i.e. technical standards, the ESA's budget and guidelines and recommendations.

Table 1: Matters where the General Board's majority rule differs from the majority of the members rule

Matter	Majority rule
Technical standards	Qualified majority
Guidelines and recommendations	Qualified majority
Financial provisions	Qualified Majority
Binding settlement of disagreements concerning consolidating supervisor decisions	Simple majority, unless blocking minority
Reconsideration of a decision to ban or restrict a financial activity	Qualified majority

Adopting decisions addressed to national supervisors in the case of settling disagreements is subject to particular rules. There are particular rules when the disagreement concerns a consolidating supervisor, i.e. a supervisor responsible for the supervision of a banking or insurance group as a whole[157]. In that case, an ESA can take decisions requiring actions by the consolidating supervisor by simple majority of votes casted. This is unless a blocking minority rejects such a decision. All other ESA decisions regarding the settlement of disagreements are taken according to the general decision making rules (a simple majority of the members).

A final particular majority rule concerns banning or restricting a financial activity. An ESA can take an initial decision by simple majority of its members. However, any Member State can request the ESA to reconsider its decision. In that case, the ESA would have to confirm its initial decision by qualified majority. The Regulations do, however, not specify a deadline for the ESA to reconsider

156. Article 44 of ibid.
157. Directive 2009/111/EC defines a consolidating supervisor as "*the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent credit institutions and credit institutions controlled by EU parent financial holding companies*".

its decision[158]. This could result in a deadlock if only a simple majority, but not a qualified majority of the Board of Supervisors supports the ESA's initial decision. In this case, supervisors may try to postpone the vote. A Member State can of course go to the Board of Appeal or the Court of Justice against an improper delay. Yet, such a procedure is also likely to be lengthy, which contrasts with the temporary nature of the prohibition. A review of the ESA regulations should address these inconsistencies.

By deciding most issues by simple majority, the ESAs can take decisions more easily than previously was the case (unanimity used to be preferred). The discussed exceptions make the use of the ESAs' most significant competences more difficult. At the same time, they ensure broad support for these decisions, which does make certain sense. Nevertheless, it seems detrimental that political compromises lead to an unnecessarily complicated set of decision-making rules.

4.4. Limits

Despite the ESAs' significant tasks and not so very demanding decision-making rules, its limits should not be overlooked. These do not only reduce the ESAs' current role, but equally pose limits to the role that the ESAs can be attributed in the future.

4.4.1. Limited supervisory role

Although the supervisory reform transformed the previous Lamfalussy level 3 Committees into European *Supervisory* Authorities, the actual supervisory role of these Authorities remains limited. As aforementioned (see 4.2.1), they are only entitled to collect information and monitor market developments, lacking the powers to conduct day-to-day supervision. Furthermore, even if the ESAs were to detect a problem in a financial institution, they would only be able to force national supervisors or financial institutions to act when directly applicable EU rules are violated or when an emergency situation was declared. In other situations, it would be much more difficult for the ESAs to have a significant influence.

Considerable direct EU supervision is currently inconceivable. Supervision is undeniably linked to financial sector crisis management and lender of last resort responsibilities, which have to take over when supervisors have failed to per-

158. Article 9(5) of ESA Regulations, op. cit. footnotes 102-104.

form their tasks. For this reason, responsibility for financial supervision ought to be in line with fiscal responsibilities in crisis situations[159]. Currently, Member States carry the burden of crisis management (see 4.4.3). Shifting supervision from the Member States to the EU without resolving the burden-sharing issue would be rightly unacceptable for Member States. Furthermore, legal issues equally prevent the ESAs to take-up more direct supervisory tasks (see 4.4.5.).

4.4.2. Procedural constraints

The ESAs have been endowed with considerable, binding competences. Yet, the use of their competences is restricted, due to lengthy procedures and/or the needed go-ahead by an EU Institution. This is made clear by an overview of the ESAs' constraints when applying five of its most significant competences:

1. The emergency powers of the ESAs can only be used after the Council declares an emergency situation, which it will not do lightly. Furthermore, decisions by the ESAs may not have a considerable impact on the Member States' fiscal responsibilities (see infra).
2. The ESAs' technical standards are drafts. They need to be endorsed by the Commission and even then they can be rejected by the either the Council or the European Parliament.
3. With regard to counteracting a breach of EU law, the ESAs can only impose its decisions upon financial institutions and national supervisors when the Commission adopted a formal opinion. Additional requirements need to be fulfilled before an ESA can address a financial institution.
4. When settling a disagreement between national supervisors, the ESAs must allow for a conciliation phase, which can take considerable time. After this phase it first has to address the national supervisors before it can require action from individual institutions. At any rate, the ESAs' decisions may not have considerable impact on the Member States' fiscal responsibilities (see infra).
5. An ESA can only ban or restrict a financial activity if specifically foreseen by EU legislation or when an emergency situation is declared. If an ESA bans or restricts a financial activity, any Member State can request a confirmation of this decision. In that case, a qualified majority in the ESA's General Board is needed to confirm the decision.

As a consequence, most of the ESAs' binding powers are only to serve as instruments of last resort. These powers are likely to be used scarcely. The ESAs' com-

159. GOODHART, C., Some New Directions for Financial Stability?, Per Jacobsson Lecture, Bank for International Settlements, 2004, pp. 7-8.

petence to adopt draft technical standards is an important exception and is likely to constitute one of the ESAs' most prominent competences.

4.4.3. Safeguards protecting national fiscal autonomy

During the European Council of June 2009 some countries where concerned about the ESAs powers. In response, a safeguard clause was introduced into the Regulations[160]. The clause limits the fiscal repercussions of ESA decisions in two fields: emergency situations and the settlement of disagreements. In both fields, the safeguard clause stipulates that an ESA decision shall not impinge on a Member States' fiscal responsibilities, thus limiting the pecuniary repercussions of the ESAs' decisions. This is especially relevant in case of a bail-out of a cross-border financial institution. During the financial crisis, Member States were almost never able to agree on burden sharing arrangements when financial institutions needed to be refinanced. Due to the safeguard clause, the ESAs will be little more than a forum for such agreements.

The safeguard clause is initiated by the non-implementation of an ESA decision by a Member State on grounds of its fiscal impact on that Member State. The ESA decision is then immediately suspended. The procedure that follows depends on whether the safeguard clause is used in an emergency situation or in case of the settlement of a disagreement, with some similarities existing between the two. In a nutshell, when settling disagreements, an ESA decision is revoked unless a majority of Member States supports the ESA decision. If an emergency situation has been declared, than the opposite applies. In such instances, an ESA decision is maintained unless the Council decides otherwise. Both procedures are detailed below.

a. The settlement of disagreements

The procedure that is followed when settling disagreements is the less complex of the two processes. Table 2 provides an overview of the procedure and time frame. In case of settling a disagreement, the safeguard procedure consists of three steps. It begins when a Member State notifies the ESA, within two weeks of the decision, of the non-implementation of the ESA decision.

160. Article 38 of ESA Regulations, op. cit. footnotes 102-104.

Table 2: Procedure and time frame for applying the safeguard clause in case of dispute settlement

Step in the procedure	Time frame
1. Member State notifies the non-implementation of a decision	2 weeks
2. ESA decides to maintain, amends or suspend its decision	1 month
3. If the ESA maintains its decision, Council needs to confirm this decision	2 months

Following the Member States' notification, the ESA has one month to decide whether to maintain, amend or suspend its decision. In case the ESA decides to maintain the decision, this must be confirmed by the Council within two months. To this extent, the Council votes by simple majority of votes casted.

b. Emergency situations

In case of an emergency situation, the safeguard procedure starts again with a Member State notifying the ESA that it has not implemented an ESA decision. Due to the urgent nature of emergency situations, a notification has to occur within three working days of the ESA decision.

The Council can subsequently revoke the ESA decision by a simple majority of its Members. If the Council takes no such measures within ten working days after the notification by the Member State, the decision is no longer suspended.

Table 3: Procedure and time frame for applying the safeguard clause in case of emergency situations

Step in the procedure	Time frame
1. MS notifies ESA on the non-implementation of the decision	3 working days
2. Council decides whether the ESA decision is maintained or revoked	10 working days
3. Council re-examines its decision	4 weeks (extendable by another 4 weeks)

However, Member States are entitled to readdress the Council a second time if this institution has chosen not to revoke an ESA decision. The ESA decision would nonetheless remain in force during the remainder of the procedure. For this second deliberation, the Council would in practice be composed of the heads of state or government, although this is not a legal requirement. The Council has four weeks to bring forth a decision, a time frame which can be extended by another four weeks if the situation so requires. Table 3 provides an overview of the procedure.

4.4.4. *Budgetary and staffing constraints*

Unlike the ESRB, the ESAs have their own budget. The ESAs' resources come from national supervisors (60%) and from the Union budget (40%)[161]. In addition, legislators can require fees from the financial sector, which then are supplemented to the ESAs' budgets. This is the case for credit rating agencies, whose fees will be added to the ESMA budget[162]. It has been argued that the ESAs' budgets and staff are very small compared to the tasks they have to perform[163]. Table 4 shows the ESAs' initial 2011 budget and their 2015 budget, when the ESAs are to be fully operational.

Table 4: ESAs' 2011 and 2015 budgets in EUR[164]

ESA / Year	2011	2015
EBA	12.682.500	24.591.000
EIOPA	10.667.500	19.955.000
ESMA	19.460.000	23.785.000
Total	42.810.000	68.331.000

A total 2015 budget of over EUR 68 million might seem impressive, but compared to national supervisors' budgets this is in fact rather small. In comparison, the British Financial Services Authority's 2009 operating costs were approximately EUR 450 million[165] and the German BaFin budget was EUR 129 million[166]. This is also reflected in terms of staff. By 2015, the combined staffing of the ESAs will be around 300, in contrast to the 3.300 employees of the British Supervisor[167]. Of course, a comparison between the EU and the national level is imperfect, as the two levels have different tasks. What the figures in any case do show is that national supervisors are by far the more dominant bodies.

161. Recital 68 and Article 62 of ESA Regulations, op. cit. footnotes 102-104.
162. European Commission, Proposal for a Regulation on amending Regulation (EC) No 1060/2009 on credit rating agencies, 2 June 2010, COM(2010) 289 final.
163. Remarks by LANNOO, K., Debriefing on European Parliament Decision on the Financial Supervision Package, Centre for European Policy Studies, 27 September 2010.
164. The 2011 figures are based on the EU 2011 budget, plus national contributions and sectoral fees in case of the ESMA. 2015 figures are based on the Commission's proposal, see: European Commission, Proposal for a regulation establishing a European Banking Authority (EBA) of 23 September 2009, COM (2009) 501 final.
165. The FSA's operating costs for the period 1 April 2009 to 31 March 2010 were £391.7 million, see: FSA, Annual Report 2009/2010, June 2010, p. 67, Retrievable on: http://www.fsa.gov.uk/pubs/annual/ar09_10/ar09_10.pdf.
166. BaFin, Jahresbericht der BaFin ´09, April 2010, p. 255, Retrievable on: http://www.bafin.de/cln_171/nn_992916/SharedDocs/Downloads/DE/Service/Jahresberichte/2009/jb__2009__gesamt,templateId=raw,property=publicationFile.pdf/jb_2009_gesamt.pdf.
167. European Commission, Financial Supervision Package – Frequently Asked Questions, 22 September 2010, MEMO/10/434.

4.4.5. Legal issues

As for the ESRB, the legal basis for the creation of the ESAs is contained within Article 114 TFEU. As aforementioned, this Article can only be used as a legal basis for an act that serves to 'approximate' Member States' legislation. In contrast with the ESRB, this requirement seems to be easily met, as the ESAs have the task of working towards a single rule book (see 4.2.2).

The ESAs' legal nature could pose more difficulties. As already mentioned, ESAs are created as EU agencies, each with a distinct legal personality. Delegating powers to independent agencies poses certain issues concerning accountability, a subject frequently discussed in economic and political theory. Therefore, the delegation of tasks is often subjected to control mechanisms and delegation limits.

In the EU such issues arise as well, as agencies operate outside of the institutional framework provided by the Treaty[168]. Case law has filled in this legal gap. The 1958 Meroni Cases are of crucial importance[169]. They set out multiple conditions for the establishment and functioning of agencies, which have become known as the *Meroni Doctrine*.

The conditions of the Meroni Doctrine are quite stringent and pose significant limits to the establishment of agencies. For this reason, the scope of agencies' tasks is limited to specialised and often technocratic matters[170]. In case of the ESAs, two interlinked conditions are of particular are particularly pertinent. As a first condition, the delegation of power can only involve clearly defined executive powers[171]. Secondly, any assessment by an agency on its own authority must be subject to precise rules so as to exclude arbitrary decision-making[172].

Most tasks undertaken by the ESAs do not pose legal issues. For example, the fact that the ESAs draft technical standards is not contrary to EU law, as it is the Commission who officially endorses them and thus carries the responsibility. Although this continuous to pose accountability issues, it offers a loophole around the Meroni limits.

168. ANDOURA, S., TIMMERMAN, P., Governance of the EU, op. cit. footnote 107, p. 5.
169. Joined Cases 9-56 and 10-56 Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community.
170. ANDOURA, S., TIMMERMAN, P., Governance of the EU, op. cit. footnote 107, p. 10.
171. Paragraph 8 of Summary of Judgment of the Court of 13 June 1958, Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community, Case 9-56.
172. Paragraph 7 of ibid.

Certain other ESA tasks may contain elements which are less compatible with EU law. In particular the dispositions on ensuring a consistent application of EU rules, emergency situations and the settlement of disagreements would confer considerable powers to the ESAs. Additional competences that are set to be conferred to the ESAs in the future may equally pose problems[173], although much will depend on the final wording. For this very reason, this paper focuses on the ESAs' current competences. Two potential areas of difficulty can be identified.

An initial difficulty is the scope of the ESAs' competences. Case law only allows the delegation of clearly defined executive powers to agencies. It is therefore not permissible to delegate broad powers. As previously outlined, the ESAs can settle disagreements, enforce EU rules, ban financial activities and oblige financial supervisors and institutions to take emergency situation measures. One might wonder if these powers are mere executive ones, even taking into account their rare use and the procedural constraints. At any rate, they stretch far beyond administrative tasks.

The second potential area of difficulty concerns the ESAs' margin of appreciation when it comes to decision-making. According the Meroni Doctrine, assessment by the ESAs needs to be based on precise rules that leave no room for discretionary decisions. It is questionable whether this is the case. Most often, the Regulations only indicate that the ESAs' decisions must be made in accordance with the applicable legislation and/or to ensure compliance with Union law. Such general references might be considered to be different from precise assessment rules. Furthermore, in some cases the ESAs have the possibility – not the obligation – of addressing financial institutions in case a national supervisor fails to comply[174]. This seems to leave the ESAs some leeway when choosing the course of action. The fact that a Board of Appeal has been created equally indicates that the ESAs' decisions or lack of decision entail a certain margin of appreciation.

Some questions with regard to the compatibility of the ESAs' competences with the Meroni Doctrine can thus be raised. Yet, the relevance of the Meroni Doctrine has been put into question. Certain authors argue that the Meroni Doctrine has de facto been repealed[175], although this is in disaccord with recent case law[176]. A

173. Matters that may pose problems include the direct supervision of credit rating agencies and the margin of appreciation to determine whether a derivative is to be centrally cleared. See: VERHELST, S., Addressing the financial crisis, op. cit. footnote 1.
174. For example, ESAs are left the choice in case of a breach of EU law and in emergency situations.
175. MAJONE, G., Managing Europeanization, p. 194, In: PETERSON, J. and SHACKLETON, M. (ed.), The Institutions of the European Union, Oxford University Press, 2006, 390 p.
176. For instance: Paragraphs 41-44 of Judgment of the Court (First Chamber) of 26 May 2005, Carmine Salvatore Tralli v European Central Bank, Case C-301/02 P, European Court reports 2005 Page I-4071.

potentially more valid argument is that the Doctrine does not apply to the ESAs. Several grounds support this argument. First, the Meroni judgement concerned private bodies, while the ESAs are public 'satellite' bodies. Second, in case of Meroni, it was the predecessor of the Commission (i.e. the High Authority) which delegated its powers. Here, the Council and the Parliament delegate tasks to the ESAs. Finally, there have been significant institutional changes since the Meroni cases. The Meroni cases applied to the European Coal and Steel Community. Since then European integration has changed profoundly[177]. These arguments are however in no way supported by case law.

In summary, the ESAs' competences are on the edge of what is legally feasible under the Meroni Doctrine, maybe even stretching beyond it. Without passing a final judgement on the matter, it seems presumptuous to assume that the Court of Justice would undoubtedly accept the delegation of powers to the ESAs. A renewed view of the Court of Justice on the delegation of powers could present a legal milestone. Accepting the ESAs' set-up could lead to an increased role for EU agencies. However, if the Court finds the ESAs' powers to be in violation of EU law, it could undermine the role of the EU in micro-prudential supervision and put the legal arrangements of several other agencies into question of as well. Such consequences could be far reaching.

177. OTTOW, A., VAN MEERTEN, H., The proposals for the European Supervisory Authorities: the right (legal) way forward? in: Tijdschrift voor Financieel recht, Deventer, 2010, no. 1/2, pp. 5-16 and DEHOUSSE, R., Misfits: EU Law and the Transformation of European Governance, New York University, Jean Monnet Working Paper 2/02, 2002, pp. 12-13.

5. National and Cross-Border Supervision

While the legislative reforms draw attention to EU level supervisors, they are in no way the only supervisors operating in the EU. In fact, EU supervisors form only a small part of the European supervisory landscape. Actual supervision of financial institutions is carried out by other supervisors. With regard to cross-border supervision, the role of colleges of supervisors has been strengthened (5.1). Yet, these colleges and the EU supervisory bodies have not replaced the pivotal role of national supervisors (5.2).

5.1. Cross-border Colleges of Supervisors: Strengthened, but Feeble

Alongside the EU supervisors, colleges of supervisors are likely to be one of the main innovations in financial supervision resulting from the financial crisis. Such college of supervisors brings together the different supervisors of the Member States in which a given financial institution or conglomerate operates. In these colleges, national supervisors are to strive towards a consensus on supervisory decisions regarding a financial institution. As a consequence of the financial crisis, colleges of supervisors have become mandatory for multinational financial institutions[178]. By 2010, more than 100 supervisory colleges had been created in the European Economic Area[179].

As aforementioned, the ESAs can participate in the meetings of colleges of supervisors (see 4.2.5), although the home supervisor chairs the meeting. While a home country supervisor needs to take the opinion of other supervisors into account, they ultimately have the final say. A college of supervisors does, therefore, not substitute national supervision.

The rise of colleges of supervisors is an important progress. Indeed, close cross-border cooperation between supervisors is vital. Yet, their weakness lies in the voluntary nature of cooperation. Rendering the colleges mandatory is a first step towards closer cooperation. Providing the ESAs with mediation competences is another important step. However, neither guarantees effective cross-border supervision. To achieve this, more binding forms of supervisory coordination would have to be envisaged.

178. Article 131a of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions [recast], OJ L 48, 30.3.2010, pp. 1-252. This obligation applies to financial institutions that are supervised by a consolidating supervisor; see Article 42a of the Directive.
179. CEIOPS, List of groups for which a College of supervisors is in place, February 2010, Retrievable on: https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/20100201-CEIOPS-List-of-groups-with-a-college-of-supervisors-in-place.pdf.

5.2. National Supervision: Where the Actual Power Lies

As for the other supervisory bodies, the crisis has induced important changes in national supervisory structures. Several Member States have revised their supervisory models, introduced or upgraded macro-prudential supervision and increased the role of central banks.

However, evolutions in different Member States are not always in line with one another. The way in which national supervision is organised is left to the Member States. As was the case before the financial crisis, the national supervisors' structure, competences and independence differ considerably[180].

Although the national supervisors are at the bottom of the supervisory system and have diverging structures, they continue to stretch out far above others supervisors in terms of competences. National supervisors' main task is to carry out day-to-day micro-prudential supervision, i.e. verify whether individual financial institutions are abiding by the relevant rules and are in sound financial health. They thus carry out the bulk of supervision related work.

Not only do national supervisors undertake the bulk of supervision tasks, they are also the central figures in the cross-border and European supervisory bodies. Colleges of supervisors are almost exclusively made up of the relevant national supervisors. National representatives equally dominate the EU bodies. The cross-border and EU level bodies are therefore no supranational entities.

Despite their pivotal role, national supervisors' powers still have their limits. The enhanced competences of EU micro-prudential supervisors imply that national supervisors can be overruled. Furthermore, the single rule book and the coordination of supervisory practices will reduce the national supervisors' discretionary powers. National supervision will increasingly be determined by the EU level. However, a shift from national to European supervision is as of now unfeasible[181].

180. Despite these considerable differences, three main models of supervision can be identified: (1) a sectoral model, where separate supervisors are responsible for supervising a specific sector of the financial industry; (2) allocation of competences on the basis of supervisory objectives (this includes the so-called 'twin peaks' model) and (3) a single supervisor, which continuous to be the dominant model of supervision in the EU Member States (although some Member State plan to abandon it). See: ECB, Recent Developments in Supervisory Structures in the EU Member States (2007-10), October 2010, pp. 1-5.
181. As aforementioned, the European micro-prudential supervisors face several limits; see in particular 4.4.1 Limited supervisory role and 4.4.5 Legal issues.

6. What about International Supervision?

The financial sector is not only integrating at the EU level, but is increasingly becoming an integrated international sector. The financial crisis demonstrated the interconnectedness of the financial sector, as well as the attached dangers. Supervision should take this evolution into account. Up to a certain extent, this has been the case in international discussions and notably in the G-20. This has resulted in expanded international financial supervision, both at the micro and macro level.

At the micro level, the role of international colleges of supervisors has been increased. Similar to EU colleges, these colleges group supervisors of multinational financial institutions. The G-20 has pushed for the creation of supervisory colleges for "*all major cross-border financial institutions*[182]". More than thirty of such colleges of supervisors have since been established[183].

As for EU supervisory colleges, international colleges aim at improving the coordination between the different supervisors. Yet, they too rely on voluntary coordination. As they are not regulated by binding rules, they even have fewer competences than supervisory colleges inside the EU. Due to this difference between EU supervisory colleges and colleges at the international level, EU supervisors often hold two-tier colleges. This implies a meeting among EU supervisors and a separate meeting with all relevant supervisors[184].

The Financial Stability Board and the International Monetary Fund have been tasked with international macro-prudential supervision. They will jointly perform Early Warning Exercises on the build up of macroeconomic and financial risks[185]. This exercise is to be conducted bi-annually. These Early Warning Exercises are similar to the work of the ESRB, but are (even) more non-committal.

182. G-20, Declaration. Summit on Financial Markets and the World Economy, Washington, 15 November 2008.

183. G-20, Progress report on the economic and financial actions of the previous G20 Summits, July 2010.

184. CEIOPS, Report on the Functioning of the Colleges of Supervisors, 20 November 2010, Retrievable on: https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/20101111-CEIOPS-2010-Report-on-functioning-of-colleges.pdf.

185. G-20, Declaration on Strengthening the Financial System, London, 2 April 2009. Each of the two international bodies will concentrate on its area of expertise, for the IMF this is economic and macro-financial topics, while the FSB focuses on regulatory issues.

Conclusion

The renewed financial supervision system has substantially altered the way in which financial supervision is carried out. The reforms were undeniably needed, and should be welcomed. Similar changes would have been inconceivable before the financial crisis.

Of crucial importance is the enhanced role of the EU level actors. At the macro-prudential level, the European Systemic Risk Board (ESRB) has been created to monitor the overall financial stability of the financial sector. At the micro-prudential level, former supervisory bodies have been revamped into European Supervisory Authorities (ESAs). The ESAs have been attributed significant competences, which are even set to gradually increase over time.

Despite their increased role, these EU level bodies do face certain limitations. The ESRB has no binding competences. Its success is, therefore, strongly dependent on the willingness of the Member States to act upon its warnings and recommendations. The ESAs' role is largely limited to undertaking and promoting supervisory cooperation and legislative harmonisation. Their function in actual supervision is limited. Moreover, the instances in which the ESAs' decisions may have a sizable impact on Member States' budgets have been limited, hampering their role in crisis management.

Besides a strengthening of the EU level, some steps have equally been taken to enhance cross-border and international supervision. Cross-border colleges of supervisors have been made mandatory, while macro-prudential supervision at the international level has been strengthened. Nonetheless, these bodies have few means to trigger policy responses, even less than the ESRB.

Despite the increased role of other bodies, national supervisors continue to be the core elements of financial supervision. Only they have both substantive supervisory tasks and the competences to enforce their decisions. Moreover, the cross-border and EU level supervisory bodies consist mostly of national supervisors. Those bodies can, therefore, not be considered supranational entities.

As a result, the asymmetry between national financial supervision and the European integration of the financial sector remains. The sustainability of such asymmetry should be a major focus of the future review, to be completed in 2014. After this, it is highly likely that the opportunity for post-crisis reform will be over.

If the review finds that a renewed supervisory system could result once again in substantial supervisory failings, more drastic reforms are to be envisaged. This could lead to the Europeanization of financial supervision. It would result in a further loss of national autonomy and would require a genuine EU approach to financial sector crisis management. More EU supervision could equally require a change in the EU's legal structure. Member States do not seem inclined to carry through such changes. Yet, if the proposed supervisory system fails in its tasks, the only real alternative to EU integration is increased national control. This would imply cutting back the single market and would, furthermore, lead to a less integrated financial sector, an unattractive prospect for policymakers.

In summary, while the supervisory reforms have been comprehensive, they have not gone so far as to solve the pre-crisis supervisory shortcomings. The reforms have rather equipped supervisors with a set of tools to address them. If these tools proof insufficient, swift reforms must not to be shied away from, even if they have far-reaching consequences. It should not take another financial crisis before policymakers dare to take new far-reaching reforms.

Annex: Composition of EU Supervisory Bodies

❖ <u>**European Systemic Risk Board (ESRB)**</u>

Chair: Jean-Claude Trichet (ECB)

First Vice-Chair: Mervyn King (United Kingdom)

National Representatives Management Board
- Marek Belka (Poland)
- Mario Draghi (Italy)
- Athanasios Orphanides (Cyprus)
- Axel Weber (Germany)

Chair Advisory Technical Committee: Stefan Ingves (Sweden)

Head of Secretariat: Francesco Mazzaferro (ECB)

❖ <u>**European Banking Authority (EBA)**</u>

Chair: Andrea Enria (Italy)

National Representatives Management Board
- Martin Andersson (Sweden)
- Sabine Lautenschlager (Germany)
- Danièle Nouy (France)
- David Rozumek (Czech Republic)
- Karoly Szasz (Hungary)
- Jukka Vesala (Finland)

Executive Director: Adam Farkas (Hungary)

❖ <u>**European Insurance and Occupational Pensions Authority (EIOPA)**</u>

Chair: Gabriel Bernardino (Portugal)

National Representatives Management Board
- Peter Braumüller (Austria)
- Matthew Elderfield (Ireland)
- Damian Jaworski (Poland)
- Flavia Mazzarella (Italy)
- Jan Parner (Denmark)
- Hector Sants (United Kingdom)

Executive Director: Carlos Montalvo (Spain)

❖ **European Securities and Markets Authority (ESMA)**

Chair: Steven Maijoor (Netherlands)

National Representatives Management Board
- Karl-Burkhard Caspari (Germany)
- Jean Guill (Luxembourg)
- Alexander Justham (UK)
- Raul Malmstein(Estonia)
- Kurt Pribil (Austria)
- Fernando Restoy (Spain)

Executive Director: Verena Ross (Germany[186])

186. Despite her German nationality, Ms. Verena Ross was previously director at the UK's Financial Services Authority.